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PHILOSOPHY IN BANKRUPTCY

David Gray Carlson*

THE LOGIC AND LIMITS OF BANKRUPTCY LAW. By *Thomas H. Jackson*. Cambridge, Mass.: Harvard University Press. 1986. Pp. viii, 287. \$25.

In *The Logic and Limits of Bankruptcy Law*, Thomas Jackson reworks his recent law review articles into a book that attempts to be a coherent jurisprudence of federal bankruptcy law. Undoubtedly, the book will find some admirers among people who think that bad law-and-economics is better than no law-and-economics,¹ but virtually all other audiences will find the book badly wanting. The book is unhelpful in solving hard interpretive problems.² No important sociological issues are discussed or even mentioned.³ On its own chosen ground of generality, Jackson's vision of the rationality in bankruptcy law is internally inconsistent and hopelessly ad hoc.

Jackson's basic technique is to filter bankruptcy law through a "creditor's bargain" model. In this model, anyone who loses his or her entitlements in bankruptcy is shown to have consented in advance

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1. See A. Kronman, *Flyleaf* to THE LOGIC AND LIMITS OF BANKRUPTCY LAW ("I cannot think of any book on bankruptcy that is comparable to this in breadth or theoretical sophistication."). I assume Kronman likes the book and is not hurling a terrible anathema at the bibliography. See also Scott, *Through Bankruptcy with the Creditors' Bargain Heuristic* (Book Review), 53 U. CHI. L. REV. 690 (1986). In this review of a bankruptcy casebook coauthored by Jackson, Robert Scott expresses the view that the contractarian heuristic developed by Jackson is "powerful," *id.* at 692, and a "significant advance," *id.* at 694, but he is astonished that contractarianism fails to explain current bankruptcy doctrine.

However, you can't fool all of the people all of the time. See Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 823-25, 827 (1985) (attacking the assumptions which fuel Jackson's hypothetical consent of creditors who are forced to give back preferences).

2. At times, Jackson does offer his views on interpretive questions, but they are almost always driven by his controversial norms of contractarianism and bankruptcy neutrality. Therefore, practitioners have to believe (or have to believe judges believe) Jackson's normative theories before they will find his legal analysis of any use.

3. I take these problems to include: (1) How can we best control expenditures by lawyers and accountants who have every incentive to work inefficiently in pursuit of the creditors' interests? (2) How can the holdout power of junior creditors be curtailed without treading upon their due process rights? (3) What is the effect (if any) of generous discharge and wage earners' plans on the moral fabric of our society?

to the loss. Somewhat separately, Jackson believes that bankruptcy should be totally neutral about property entitlements created by state law. Otherwise, "incentives" are created.⁴

In this essay, I will present some criticisms of these two propositions. My conclusion will be that, at his best, Jackson rises to mere tautology. Beyond that, Jackson entangles himself in unreconciled contradictions and depends upon factual assertions that no one could accept as true. Almost never does he produce an insight that can survive serious scrutiny.

I. JACKSON'S CONTRACTARIAN METHODOLOGY

Jackson joins a distinguished coterie in pursuing contractarian theory. Hobbes, Locke, and Rousseau also find in hypothetical contracts a means by which the postulate of individual sovereignty may be reconciled with coercive government power.⁵ The practice of contractarian theorists is not to argue that any real human being has actually manifested consent. Instead, they present an *essence* of the human personality in the abstract, devoid of historic characteristics. These personalities are defined by a very limited number of attributes that the theorist perceives to be universal among humans. Defined by these limited attributes, such personalities, it is argued, would consent to socializing institutions that involve coercion and pain.

Contractarians are often persuasive in arguing that humans (as *they* reconstitute them) *would* pursue the rationality dictated by the attributes and needs assigned to them and would indeed agree to future coercion.⁶ The controversial aspect of contractarian rhetoric is whether the theorist has introduced a plausible account of personality. If you don't agree that human beings have been abstracted fairly in the contractarian model, then the model fails to have any rhetorical value.⁷

For this reason, most contractarians keep their hypothetical human beings highly abstract and simple. Rawls, for example, places

4. "Bankruptcy neutrality" is my term. Jackson writes only about the evil of "incentives." A world *without* incentives can be described as neutral. Neutrality allows creditors and debtors to make optimal choices. See text at notes 116-18 *infra*.

5. For an excellent account of contractarianism, see Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769 (1985) [hereinafter Rosenfeld, *Contract and Justice*].

6. See *id.* at 818 ("the ultimate criterion of whether a relationship is contractual in its deep structure is not the actual agreement of those involved, but rather the logical likelihood that those involved, acting as rational, self-interested individuals, would freely agree to the relationship").

7. In characterizing a contractarian model's value as "rhetorical," I follow Ronald Dworkin in assuming that contractarianism proves nothing about the ethical quality of an institution and simply serves as "a device for calling attention to some independent argument for the fairness of [an ethical proposition] — an argument that does not rest on the false premise that a hypothetical contract has some pale binding force." Dworkin, *The Original Position*, in READING RAWLS 16, 19, 37 (N. Daniels ed. 1975); see also *id.* at 37.

human beings behind a veil of ignorance and strips them of any historicity. He is refreshingly candid about this process and goes so far as to admit that, in the end, his own version of contractarianism does not depend upon universal agreement at all. It is enough that *one person* thus abstracted would consent.⁸ In the Rawlsian model, all people are so completely stripped down that they are precisely alike; a "bargain," strictly speaking, is not required.⁹

Another important feature of contractarians such as Rousseau or Rawls is that they use their contractarian models to investigate only the most basic of human institutions. Given the fact that human beings in such contractarian models are stripped of their historicity, no other strategy is possible. If these philosophers were to attribute real histories to the people in their hypothetical bargains, they would become less and less likely to reach the stipulated bargain. It might still be open for the philosophers to argue that real historic people *ought* to agree, but infusing such oughts into the discussion deprives contractarian philosophy of its major value: the ability to avoid, to a fairly great extent, the need to justify the truth of normative propositions.

This implies that contractarianism is not a very effective technique to pursue economic efficiency. Unlike basic institutional questions, which depend upon very abstract assertions of human desire, efficiency requires a close analysis of precise historical attributes of human beings.¹⁰ Identifying the *ex ante* state in which a loser would have consented to a disadvantageous-but-efficient law almost always requires an ad hoc attribution of historic qualities to the person who would agree to take the loss.¹¹ However, in spite of the utilitarian's heavy reliance on historical attributes of persons, Archimedean contractarianism has attracted some law-and-economics professors¹² precisely because it answers a very difficult ethical question about cost-benefit analysis: why should a person incur costs just so some other people can benefit?

There are noncontractarian answers to this question of why a few

8. J. RAWLS, A THEORY OF JUSTICE 139 (1971).

9. See M. SANDEL, LIBERALISM AND THE LIMITS OF JUSTICE 77-99 (1982); see also Yablon, *Arguing About Rights* (Book Review), 85 MICH. L. REV. 871, 877-79 (1987).

10. "[U]tilitarian doctrine . . . relies very heavily upon the natural facts and contingencies of human life in determining what forms of moral character are to be encouraged in a just society." J. RAWLS, *supra* note 8, at 32; see also Pence, *Fair Contracts and Beautiful Intuitions*, in NEW ESSAYS ON CONTRACT THEORY 137, 144-45 (K. Nielsen & R. Shiner eds. 1977) (utilitarians cannot agree on specific principles that would be perpetually valid, because the circumstances of society change).

11. See Dworkin, *Why Efficiency?*, 8 HOFSTRA L. REV. 563, 578-79 (1980) (criticizing Richard Posner's contractarianism on this ground).

12. For a persuasive argument which suggests that a chief difference between efficiency contractarians (such as Posner) and deontological contractarians (such as Rawls) may be the willingness to attribute knowledge of probabilities to people in the original position, see Hare, *Rawls's Theory of Justice*, in READING RAWLS 81, 101-07 (N. Daniels ed. 1975).

should consent to suffer for the many, but they mostly involve the invocation of communitarian (*i.e.*, nonliberal) values. Efficiency contractarians, however, tend to value the (contradictory) principles of individualism. This leads law-and-economics professors to the strategy of showing that, irrespective of supererogatory ideals, selfish individuals would have consented to risk if they had been asked at a time long before their histories became known to them. This point in time is defined as one at which the present value of *everyone's* future entitlements is maximized. Since people would consent to having more rather than less, Kaldor-Hicks efficient¹³ moves appear as though they are products of Pareto superior¹⁴ consent.

Usually, the bargain posed by efficiency contractarians goes like this:

Contractarians:

We have here a proposal for an efficient rule that enriches investment bankers at the expense of widows and orphans. Between you people, none of you now knows who will be the investment banker and who will be the widow. We do know that we can have a regime with no winners or losers, but it will be poorer overall. The average share of such a society has a low discounted value at this time. On the other hand, if you are willing to take some risks, then your share of the good things in life has more present value.

Abstracted Persons:

We are risk-neutral wealth maximizers. We are willing to risk a loss in the hope of achieving even greater wealth. We have no knowledge whether we'll be the widow who is disfavored, or the investment banker who reaps all the gains.¹⁵ The efficient rule, however, increases the value of our chances for the good life. Therefore, we consent to the rule that favors investment bankers over widows.

Such arguments, I think, are ineffective. One cannot really fathom a time when people are so disembodied from their histories that they have no idea whether they are more likely to be investment bankers or widows. It can hardly be denied that most people's fates are substantially determined at the moment they are born. Therefore, the *ex post* losers in the above example need not always be persuaded that it is a

13. A redistribution of resources is Kaldor-Hicks efficient if and only if under the redistribution the winners win enough so that they could compensate the losers. The notion of Kaldor-Hicks efficiency does not require that the winners actually compensate the losers. In effect, a redistribution is Kaldor-Hicks efficient if and only if it is a "possible" Pareto superior redistribution.

Coleman, *Efficiency, Exchange and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221, 239 (1980).

14. "A change is said to be Pareto superior if it makes at least one person better off and no one worse off. Such a change by definition increases the total amount of (human) happiness in the world." R. POSNER, *THE ECONOMICS OF JUSTICE* 54 (1981).

15. They *do* know they are adult humans, which fixes the game with regard to such difficult issues as abortion (*i.e.*, they know they won't be aborted fetuses) and the superiority of average utility standards over total utility standards. See Hare, *supra* note 12, at 99-101.

good thing that investment bankers win at their expense.¹⁶ Such arguments depend for their validity upon how attractive a portrait contractarians draw of the abstracted individual.

I therefore come to Jackson's scholarship with a great deal of skepticism that contractarian fictions can breach the enormous gap between Pareto and Kaldor-Hicks economics. But beyond challenging the persuasiveness of the technique, I have two other complaints about the way Jackson practices his contractarianism. First, in pursuit of efficiency, Jackson uses the model ineptly. His models don't show what he claims they do. Second, Jackson, without warning, maintains the facade of contractarianism while dropping utilitarianism as the basic normative goal. The switch from utilitarianism to a "justice as fairness" view suggests to me that Jackson's jurisprudence is ad hoc and inconsistent, having as its only end (a) the legitimation of whatever the legal status quo happens to be, and (b) the maintenance of a deceptively calm contractarian surface.

My critique of the efficiency version of his contractarianism will center on his allegation that all or most creditors would bargain to get equal priority in bankruptcy. My critique of his nonefficiency contractarianism will focus on Jackson's explanation of bankruptcy discharges. Each justification is based on radically different theories of the human personality, a change that Jackson fails to justify or even to make explicit.

A. *Creditor Priorities*

A central claim of Jackson's book is that all creditors would agree to equal priority in bankruptcy. This is the so-called "creditor's bargain."¹⁷ The logical steps to this conclusion are as follows: (a) Nonbankruptcy law is the "state of nature" out of which the creditor's bargain emerges (pp. 4, 8). (b) The essence of nonbankruptcy debtor-creditor law is "first in time, first in right,"¹⁸ a concept that preexists creditor equality. (c) Creditor equality is in turn the essence of bankruptcy (p. 15). (d) Creditors have a precisely equal perception of their chance of winning a priority collection in case the debtor becomes insolvent (pp. 15, 30-31). (e) Creditors care only about maximizing their recovery; they have no altruism about their fellow creditors and no

16. See J. RAWLS, *supra* note 8, at 171 ("We must not be enticed by mathematically attractive assumptions into pretending that the contingencies of men's social positions and asymmetries of their situations somehow even out in the end. Rather, we must choose our conception of justice fully recognizing that this is not and cannot be the case.").

17. The phrase is introduced in Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982).

18. Pp. 8-9 ("It is like buying tickets for a popular rock event or opera: the people first in line get the best seats; those at the end of the line may get nothing at all."). Query whether this metaphor describes either state debtor-creditor law or allocating seats to the opera. In my experience, the people with the best seats would never dream of standing in line for them.

particular animus toward them either. (f) If the creditors act together, they can gain, either by (i) capturing the "going concern" value of an enterprise, or at least by (ii) reducing the administrative cost of recovering from the debtor.

Unfortunately, each and every assumption in Jackson's model is open to challenge. As a result, this model proves nothing about the institution of creditor equality in bankruptcy. In fact, even on his assumptions, Jackson does not prove that equality is the *only* agreement the creditors could possibly reach. Not only would these creditors agree to bankruptcy equality, but they would agree to bankruptcy inequality as well, if Jackson asked them to.

Let's go over Jackson's logical steps one by one. I think we'll find almost no step along the way that is valid. In addition, we'll see that the model itself is a failure, because the conclusion is a non sequitur in relation to the premises of the model.

1. *Essences and Exceptions*

In attempting to show that the status quo is fueled by rational normative principles, Jackson must, of course, describe what he takes the status quo to be. According to Jackson, the essence of state debtor-creditor law is a race of creditors to grab what they can. In contrast, the essence of federal bankruptcy law forces creditors to be treated equally. If Jackson has wrongly identified these essences, his work has been severely disabled, since these claims of competing essences fuel a gigantic portion of the book. The following paragraphs will argue that Jackson has no good justification for his essentialism.

a. The essence of state law. State (or nonbankruptcy) law does give rise to a race among creditors to obtain judicial liens, of course, but it also contains norms of creditor equality. These equality norms are found in state receiverships and assignments for the benefit of creditors. Because receiverships and assignments for the benefit of creditors exist in state law along with the creditor race, Jackson cannot rely on the *content* of state law as the source of essence. On what basis, then, can Jackson say that the creditor race is the essence of state debtor-creditor law while creditor equality is the exception?

One possible method of supporting this statement would be an empirical study counting up the number of times creditors pursue insolvent debtors with judicial liens and how many times they pursue debtors under state-law regimes of creditor equality. This is not done in Jackson's book. Indeed, Jackson simply assumes the essence of state law is self-evident. Let's stipulate that state courts today see relatively few receiverships or assignments for the benefit of creditors. This was not necessarily true throughout the nineteenth century, before Congress established the current federal bankruptcy regime, when business insolvencies were especially likely to be the subject of

state-created collective proceedings. Certainly in the nineteenth century it might have been possible to claim that neither creditor equality nor creditor races predominated in state debtor-creditor law.

If "first in time" is the essence of state debtor-creditor law, it is only a twentieth-century essence. This development is itself surely the product of federal bankruptcy law. That is, once Congress enacted a federal bankruptcy law,¹⁹ the use of creditor equality systems in state law became subject to competition from the federal system. This does not necessarily mean that state legislatures no longer cared about or would oppose creditor equality. It does say something about the comparative advantages of federal or state forums, but this conclusion is a far cry from arguing that creditors would contract out of "bad" state law in favor of "good" federal law.

These comments are designed to show that the norm of "first in time, first in right" cannot necessarily be essentialized on the strength of historical claims. But a further point must be made against using history to justify Jackson's essentialism. In the absence of a bankruptcy, surely the most common practice of creditors is to walk away from a claim and forget about it.²⁰ If we are going to assign "essences" on the basis of practice rather than the content of state law, the essence of state debtor-creditor law will be no law at all, an essence in which creditors find themselves treated equally.

b. The essence of bankruptcy. Not only is Jackson's account of the essence of state debtor-creditor law open to challenge, but his account of bankruptcy's essence is also dubious. Jackson claims that the essence of bankruptcy is creditor equality. This claim is not borne out by examining the content of the bankruptcy statute, which contains all sorts of creditor priorities,²¹ nor is it borne out by empirical investigation. Bankruptcy statistics show that the vast majority of dollars produced by bankruptcy trustees go to administrative expenses and priority creditors.²² On the basis of practice, the numbers strongly suggest that creditor inequality is the essence of bankruptcy.

The posture that Jackson takes toward the essence of bankruptcy is that state law (defined as the creditor race) is bad, and that creditors would gladly agree among themselves to do away with it. Bankruptcy equality is good, however, because it is consistent with the contract the creditors would have made among themselves if it had been convenient to do so. It seems more than fair to ask, however, why Jackson

19. Assuming for the moment that creditor equality is the essence of federal bankruptcy law, which is also open to dispute. See text at notes 21-22 *infra*.

20. See Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 102 (1984) ("Most businesses fail without a bankruptcy petition ever being filed.").

21. 11 U.S.C. §§ 507(a), 726(a) (1982 & Supp. III 1985).

22. ADMINISTRATIVE OFFICE OF THE UNITED STATES, TABLES OF BANKRUPTCY STATISTICS DURING THE FISCAL YEAR ENDING JUNE 30, 1977, at tables F.5 and F.6.

should treat federal bankruptcy law as the distillation of pure reason and state law as some sort of autochthonous phenomenon that is always "prior" to creditor equality. If indeed state creditor races are bad, then where did the state law come from? If the object of debtor-creditor law is to give the creditors what they want, then why did state law end up the way it did?²³ These are not questions that Jackson addresses in his book.

The fact that state law already contains norms of communitarian sharing implies that Jackson has presented a false choice to the hypothetical creditors in his bargaining model. As state-law creditors, they already can force each other to share. Their consent to a communitarian federal bankruptcy proceeding is therefore unrelated to maximizing profits by capturing the enhanced value of the estate in bankruptcy. Federalization of state debtor-creditor law has to be justified by principles that are closer to the logic of diversity jurisdiction than to the logic of profit maximization.²⁴

To summarize, Jackson claims that he can decode the essences of state and federal debtor-creditor law, but he doesn't say where these essences come from. If they simply emanate from the text of statutes, then Jackson's claims are flatly contradicted by the presence of creditor equality in state law and creditor priorities in federal law. If they come from observation of historic behavior, Jackson's claims seem poorly supported. The false assertion of the essences of law is not a minor flaw. Throughout his book, Jackson simply assumes that the values present in state law (creditor race) are prior to the values in bankruptcy law, and that bankruptcy law can only be justified in the context of state law.

2. *Equally Powerful Creditors*

In order for Jackson's contractarian justification of creditor equality to work, it is necessary for Jackson's abstract creditors to be equal to all other creditors in their ability to collect. Therefore, at the core of Jackson's model is the notion that creditors are already deemed to be equal. Equal creditors are then shown to agree upon equality.

Isn't this smuggling the rabbit into the hat?²⁵ It shouldn't take any empirical study to convince you that creditors are *not* equal in their

23. The answer, of course, is that state law *did* pursue the norm of creditor equality and that Jackson's identification of the essence of state law is false.

24. Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 U. PA. L. REV. 69, 105-06 (1982) (suggesting that a national Bankruptcy Act was a response to parochialism in state debtor-creditor law).

25. By adopting the assumptions he does, Jackson runs afoul of the following excellent tip: "[T]he [contractarian] philosopher wants to start from weak, uncontroversial assumptions to secure the widest possible agreement in the philosophical community. If he begins with controversial assumptions, he may be accused of arbitrariness or simply begging the question." Pence, *supra* note 10, at 138.

ability to collect. Historic creditors differ in their leverage and knowledge, their skill in obtaining payment or liens, and their opportunity costs of litigating. Profit maximizing creditors who are powerful vis-à-vis other creditors would not agree to give up power to weaklings unless they were compensated for it. Creditors who are weak would love to take power from stronger creditors, if they could. Whether there's a bargain to be made here is entirely an empirical proposition. If more credit volume comes from creditors who are weak than from creditors who are strong, the debtor may be able to buy off the strong creditors' consent with higher interest financed by the savings in interest that the debtor will obtain from the weak creditors, but this is not the *ex ante* bargain between *equal* creditors that Jackson imagines. It is a model based upon information asymmetries between inherently unequal creditors.²⁶

Jackson acknowledges that his readers might challenge his assumption that, outside of bankruptcy, creditors are equal. Jackson writes:

These assumptions may not matter to the actual conclusion. Because of the "race," many of the special advantages one creditor holds may be worthless. Participation in or monitoring the race will be costly for *all* creditors. In any event there will be residual elements of uncertainty of relative rankings that could be eliminated to the benefit of all creditors. Finally, there would be distinct advantages to a legal rule that presumed equality in the position of all creditors with similar legal entitlements, instead of delving into a case-by-case examination of factors, such as "knowledge" or "friendliness." [p. 15 n.18]

In this passage, Jackson is simply stating that a creditor may feel advantaged under state law, but that the creditor may be wrong, in which case the creditor *should* prefer the equal priority in bankruptcy. This response could not be more lame. Jackson cannot dismiss positional advantages simply on the ground that the positional advantages "may" not exist. They *do* exist in nature,²⁷ and his suggestion that creditors "may" be deceived does not serve to convince us that all creditors are equal in their power over the debtor. The whole premise

26. Curiously, such a model would more closely resemble one Jackson developed to explain the efficiency of secured credit. See Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979). It may be asked why the asymmetries assumed in that article have been forgotten in Jackson's subsequent book.

27. See Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 960-62 (1985) (questioning whether general creditors are completely equal in their power attributes).

Elsewhere, Jackson makes much of the fact that we can never judge the rationality of others. Pp. 242-43. But here, in order to save his model, Jackson judges creditors to be irrational if they believe themselves advantaged under state law.

Jackson uses his "maybe they're wrong" tactic to explain why unperfected security interests should be void in bankruptcy. According to Jackson, it *seems* to unperfected, secured parties as though they have a better position under state law than do general creditors, but *maybe they're wrong!* In any case, argues Jackson, it is too expensive to look into it, so destroying the unperfected security interest is advisable. Pp. 72-74.

of the objection Jackson must deal with is that positional advantage under state law is *not* worthless.²⁸

The other parts of the quoted passage are equally unsatisfactory. The observation that the creditor race is "costly" is completely irrelevant. Rights are always "costly" to enforce, but if an investment in enforcement promises a gigantic return, mere costliness will not persuade a creditor to give up profitable rights. All gains come at the expense of *some* investment. You can't plead the fact that investment requires capital in support of the view that investors would prefer not to invest.

Similarly, when Jackson suggests that "there would be distinct advantages" in simply assuming that all creditors are equal, he forgets that he is trying to convince *us* that creditors would consent to equal bankruptcy priorities. There are "distinct advantages" only to those people who *need* to believe that Jackson's contract model is in any sense true. For those of us who feel no such need, and who expect Jackson to convince *us* that bankruptcy equality is Pareto superior to state law, I see no "distinct advantage" at all in assuming that all creditors in real life are precisely equal in their power over the debtor. Quite the contrary. A rule that ignores the differences of creditors has the distinct *disadvantage* of producing the very false impression that Jackson's contractarian model has a modicum of validity.

The above argument is the best Jackson can do to defend the claim that all creditors are equal under state law, but it's a pretty sad tactic. Jackson may deserve some credit for at least recognizing that his argument has an enormous, gaping hole in it, but the words he throws into the breach are nonsensical. He has not even come close to saving his argument from the empirical weakness upon which it rests.

3. *Equals Agreeing Upon Equality*

Ironically, even though it is natural to assume that a priori equal creditors agree to be equal, it turns out that not even this pitiful thesis is justified under the assumptions Jackson gives us! In fact, depending on what question they are asked, equal creditors might also agree on unequal priorities. Furthermore, *unequal* creditors can be made to consent to *equal* priorities.

Jackson's mode of obtaining hypothetical consent involves going back to a time when state law existed and bankruptcy did not. Jackson then sits down with two representative creditors and conducts the following conversation:

28. Yet another logical flaw in this rehabilitating strategy might be mentioned. If a creditor feels strong under a "first in time" regime but is deceived, then how did the *other* fellow obtain his strength? The answer must be that he also obtained it through reliance on state remedies. If so, how do we know the creditor who feels powerful is the one deceived about state law, and not the other competing creditor?

Jackson:

Listen, you two guys are completely equal in your ability to collect at state law and you care only about maximizing your collection. You'll be better off in a bankruptcy with equal priority, because then you two can split the increased value of the estate that the collective proceeding produces. So how about it? Do you consent to be equal in bankruptcy?

Creditors:

We consent. We get more in bankruptcy than out of it.

What could be more rational than such a conversation? Rational though it may be, the possibility of such a conversation does not disprove alternative conversations. An infinite number of other conversations are equally plausible. For example:

Jackson:

The equal priority deal is off. I've just decided I don't like Creditor *A*'s face. And just to spite him, I now offer you the following deal. There's a bankruptcy gain (say, \$20,000) to be divided here. I propose to give Creditor *A* what Creditor *A* would have gotten under a race priority (discounted by the risk that *A* might lose the race). In addition, we'll give Creditor *A* \$10 of the \$20,000 gain. Because I like Creditor *B* better, he'll get the rest. And by the way, I've just noticed that you have to take state law or whatever bankruptcy proposal I choose to make. In that case, I think I'll help myself to \$5,000 from the kitty as a little commission for myself. But only if you creditors agree, of course!

Creditor *B*:

Hey! Sounds great. I accept. I'm much better off in bankruptcy than under state law.

Creditor *A*:

Well, I'm better off by \$10 in bankruptcy than under state law. I care only for profits and do not feel the sting of insult. I accept too!

In the second conversation, the creditors have agreed to unequal bankruptcy priorities (and a little *pourboire* for Tom Jackson himself). Yet on the premises of the creditors' bargain, they had to agree. The "consent" that Jackson has found is purely a product of the fact that the creditors *must* take a low-level state law entitlement *or* whatever bankruptcy entitlement Jackson chooses to propose. Under these premises, so long as each profit-maximizing creditor makes a gain in bankruptcy, Jackson could win consent from the creditors to a variety of propositions. All that is required to produce creditor consent is that each creditor get more from bankruptcy than from state law.

The reason that Jackson's contract model is so indeterminate is that Jackson has erroneously connected the existence of bankruptcy efficiencies with the institution of creditor equality. The two have no logical connection whatsoever. They are non sequiturs.²⁹ Stipulating

29. That entitlements are non sequiturs to the maximization of a joint venture was a central insight of Coase. See Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387, 396 (1981).

Jackson himself recognizes (for other purposes) that there is no connection between priority

the existence of a wealth gain does not prove that profit-maximizing creditors *must* as a consequence agree to divide up the gain equally. In fact, with Jackson in charge of permitting legislation onto the floor, equal *or* unequal creditors will agree on any distribution that gives them more than they would have received under state law.³⁰

There *is* a way that Jackson might have rehabilitated his hypothetical consent. He might have proceeded as follows:

Jackson:

All right. We've got a \$20,000 gain here if we can agree on a federal bankruptcy system. I'm not even going to suggest how to divide it up. You creditors will have to fight it out.

Creditors:

If we had different bargaining skills, we might divide up the surplus in an unequal way, but since we are equal in *all* ways, including in bargaining skills, we hereby agree to divide the spoils equally.³¹

Notice that my rehabilitation of the creditor's bargain does *not* force the creditors to choose between inefficient "first in time" priorities and whatever bankruptcy rule Jackson dreams up. It simply assumes that the creditors have the bankruptcy surplus as an entitlement (*i.e.*, that priority is logically unrelated to the existence of the surplus). The creditors can propose among themselves a variety of rules.

The above rehabilitation would have been an empty victory, however, if Jackson had thought to undertake it. It has the flaw of reintroducing the need for creditors to be equal in order to agree among themselves to be equal. If creditors do not feel equal, there is no guarantee that equality would emerge from such a pot-splitting session. Creditors who would do better under state law will simply veto any proposal that does not recognize the value of their state law entitlements.

4. *Profit Maximization and the Ideology of Equality*

The creditor's bargain assumes (a) that creditors have equal power under state law, and (b) that creditors desire to maximize profits (to the exclusion of all other human desire). This latter assumption is

and joint maximizing behavior. In a boring and very condescending metaphor about overfishing a lake, Jackson sees that you can give one fisherman the lion's share without threatening sound husbandry principles. Pp. 58-59. *Cf. In re Findley*, 76 Bankr. 547, 551 (Bankr. N.D. Miss. 1987) (catfish in Mississippi thrive even though encumbered by a lien). And he argues that giving secured parties more entitlements in bankruptcy will not deter a bankruptcy court from capturing the going-concern value of a business enterprise. Pp. 181-90. It must also follow that giving unsecured creditors unequal priorities also has no relation to going-concern value. This is not a contradiction Jackson manages to acknowledge, however.

30. See generally R. WOLFF, UNDERSTANDING RAWLS: A RECONSTRUCTION AND CRITIQUE OF *A THEORY OF JUSTICE* 43-45 (1977) (making a similar criticism of Rawls).

31. See R. NOZICK, ANARCHY, STATE, AND UTOPIA 198-99 (1977) (when distribution of a surplus is unrelated to its production, equals agreeing to equality becomes plausible); R. WOLFF, *supra* note 30, at 32 (two players in a zero-sum game could rationally decide to be equal under the "maximin" principle).

very unreal,³² but it serves an important purpose. It gives the impression that creditor equality is the product of self-interest. Without it, Jackson would have to argue that even equally powerful creditors favor equality only when they view each other as moral equals. If he were compelled to admit this, the creditor's bargain would be exposed as a complete tautology: creditors want equality because creditors want equality.

Profit maximization (among equals) therefore displaces all other forms of ideology and allows the illusion that the norm of equality is produced by self-interest. But this illusion is the product of extremely unrealistic assumptions about human nature. Not only are real-life creditors unequal in power, but they certainly do not care only about maximizing profit.³³

The addition of other conflicting ideologies may produce a "creditor's bargain" for inequality. For instance, suppose that the creditors are workers who face major displacement costs, separate from their claims for back wages, because their employer has gone bankrupt. Such creditors (and other sympathetic creditors) might feel that these displacement costs, which cannot be recovered in bankruptcy, justify a high priority in bankruptcy for their back wages.³⁴ They may further feel that they have a moral claim to the means of production that outranks the claims of debenture holders and financial institutions.³⁵ These creditors might not agree to creditor equality and might insist on a bankruptcy priority for wage claims.³⁶

Attributing a desire for profit maximization to (hypothetically equal) creditors seems indistinguishable from attributing to real creditors a taste for equality. In either case, deriving norms of equality

32. Profit maximizing is a much discredited assumption within the neoclassical theory of the firm. Today, economists would say that firms seek a mix of leisure, prestige, self-fulfillment, and comfort, to mention a few loss leaders. See M. BLAUG, *THE METHODOLOGY OF ECONOMICS* 175-87 (1980).

33. For an excellent treatment of self-interest and its relation to other normative beliefs, see Harrison, *Egoism, Altruism, and Market Illusions: The Limits of Law and Economics*, 33 UCLA L. REV. 1309 (1986). Harrison writes:

But now that we have discovered the opportunity to divide the surplus, we must also agree on what constitutes an equitable division. We bring to this problem our own subjective notions of equity. Even if we do not use any bargaining strategy and cooperate fully in our attempts to find a division that is fair, we may not succeed in agreeing on what constitutes a fair division.

Id. at 1332-33 (footnote omitted). In this passage, Harrison implies that an *equal* division of a surplus might depend heavily on a pre-existing belief in the rightness of equality.

34. *Cf. In re Continental Airlines Corp.*, 64 Bankr. 862, 863 (Bankr. S.D. Texas 1986) (Civil Aeronautics Board refused to approve merger unless dislocated employees received cash awards for moving expenses).

35. *E.g., In re Continental Airlines Corp.*, 64 Bankr. 858 (Bankr. S.D. Texas 1986) (wage earners make unsuccessful claim for intentional infliction of emotional distress because employer filed for bankruptcy).

36. And indeed they get priority for wage claims. 11 U.S.C. § 507(a)(3)-(4) (1982 & Supp. III 1985).

from the tastes and desires of people in society lays bare a psychological assumption implicit in contractarian theory. Contractarianism is based upon a deep pessimism about whether the theorist can justify to himself or others what is good or bad in this world. This pessimism often leads the theorist to acquiesce to whatever other people want. In its utilitarian phase, such pessimism could lead to acquiescence in moral monstrosities, if other people want moral monstrosities (and they sometimes do). The truth of the matter is that efficiency-based contractarians like Jackson aren't utilitarians at all. Rather, they are conservatives who like the status quo and (in this status quo and none other) find the language of utilitarianism a fancy way for them to sound neutral and scientific. In the antebellum south or in nineteenth-century London, I suspect that conservatives used utilitarian dogma to support some very nasty public policy,³⁷ but since conservatives today have radically different preferences than conservatives in those eras, they would quickly reject legitimate utilitarian arguments made in such societies. For conservatives who apologize for the status quo with utilitarian arguments, deference to the wants and desires of others is not really the point at all. Rather, non-neutral admiration for the dominant beliefs already present in society is the point.³⁸

5. *Enhanced Value of the Bankrupt Estate*

Suppose Jackson is right in claiming that all creditors are equal in collecting power and are greedy to the exclusion of all other human attributes. Jackson's contractarian justification of equal priorities in bankruptcy still requires a belief that communitarian bankruptcy enhances the value of the debtor's property while selfish state-law systems do not.

If such an assumption is valid, it is true by definition that equally powerful creditors as a whole would prefer to share equally in a larger pie than to share equally in a lesser pie. This is merely the same as saying that creditors prefer the bigger pie over the smaller pie. Or, dividing each side of the formula by pie, big is big compared to small.

Even this modest conclusion presupposes one of two facts: either (a) bankruptcy produces more value from assets than do state enforcement systems, or (b) bankruptcy law saves more enforcement costs than nonbankruptcy law (pp. 14-17). These factual assertions are not self-evident.³⁹ It is possible to imagine systems in which the sheriff has

37. Bentham, for example, had no trouble justifying slavery by the principles of utilitarianism. R. POSNER, *supra* note 14, at 34.

38. Thus, Posner chickens out and comments, "The fact that much racial discrimination may be efficient does not mean that it is or should be lawful." R. POSNER, *supra* note 14, at 363.

39. Indeed, throughout most of the book, Jackson rails against non-neutral incentives. It turns out these incentives are bad because they might lead to inefficient bankruptcies. See text accompanying notes 116-17 *infra*. Even Jackson, from time to time, does not believe that the efficiency of bankruptcy is self-evident.

the motive to maximize the sales price, as where her poundage fee is directly related to the sales price. After all, how is the bankruptcy trustee's motive any different? Her fee too is based upon maximizing the sales price.⁴⁰

In fact, Jackson identifies only one kind of value enhancement in bankruptcy: the capture of going-concern value. I find this confusing, since bankruptcy liquidations do not depend on capturing going-concern value. For cases in which going-concern value is absent, Jackson gives no clue as to why or whether bankruptcy liquidations can enhance the value of the estate better than state-law liquidation systems. In any case, we don't inevitably need a bankruptcy system to capture going-concern value. State receiverships could do the same.⁴¹

The allegation that state law produces more enforcement costs than bankruptcy is also not proven. One can imagine all sorts of extra legal costs in bankruptcy that might not exist in state law. Junior creditors, for example, have an incentive to expend legal fees in challenging valuations of collateral in bankruptcy, or in getting their trustee to challenge voidable preferences. These costs might be reduced or eliminated under state law, where the secured party simply holds a sale.

This is a good place to invoke the Coase Theorem, which holds that the background legal regime does not matter; profit maximizing people will maneuver to maximize profit whether in or out of bankruptcy.⁴² Jackson presents no clear picture of why state law inevitably sacrifices going-concern value and bankruptcy does not.

6. Summary

Jackson's "creditors' bargain" is even less than a hollow tautology. It is based on a false picture of legal doctrine. The bargain is the product of creditors being totally equal in all aspects and completely apathetic to status and prestige between themselves, a highly unbelievable portrait of historically situated human beings. Finally, the bargain for equality ends up being a non sequitur. Profit-maximizing creditors would agree to *anything* so long as they get more in bankruptcy than out of it. For these reasons, Jackson's contractarianism fails to justify the institution of federal bankruptcy.⁴³

40. 11 U.S.C. §§ 326, 330 (1982 & Supp. III 1985).

41. Chapter Seven liquidations routinely occur when there is no going-concern value. Personal bankruptcies are radically divorced from going concern value as well.

42. Jackson is not completely unaware of the Coase Theorem. Elsewhere, in explaining the existence of going-concern value, he disposes of the Coase Theorem as follows: "Suffice it to say, for our purposes, that informational and transactional barriers are often sufficient to permit this discrepancy to exist." P. 14 n.17. Such a rationale seems dangerously close (let's face it, identical) to deducing the existence of transaction costs solely from the fact that reality does not match up to Jackson's theory. No law-and-economics theory is *ever* wrong if such deductions are permitted.

43. It might be fair to ask if I have any better suggestions than Jackson for attributing

B. Discharge of Debt

1. From Individualist Efficiency to Inefficient Individualism

Throughout most of the book, Jackson uses his contractarianism to show that bankruptcy law is efficient and that profit-maximizing creditors and debtors would have agreed to the rules if they had been consulted in advance. No one is hurt unless he or she has consented, and society is wealthier to boot. By cooking the facts, Jackson produces a happy confluence between individual sovereignty and utilitarian justifications for bankruptcy law.

Contractarianism, however, is not itself a philosophy or ethical theory. Rather, it is merely a rhetorical device by which philosophers argue for other theories — theories presentable without appeals to hypothetical consensus.⁴⁴ By now, it should be apparent that Jackson is able to make the claim of unanimous consent only by using an ex-

"meaning" to the equal priority in bankruptcy. I do. My interpretation does not go to the phenomenon of federal bankruptcy, but rather to the idea of creditor equality in any kind of collective proceeding.

My own view is that creditor equality could be viewed as a chapter in the general move from status to contract. Creditor equality might help to further the move in diminishing the importance of "status" relations between particular creditors and particular debtors. The race of diligent creditors promotes the interests of those vested with power over and information in the debtor, because knowledgeable or influential creditors are more likely to win the race. *Worseley v. DeMatteis*, 96 Eng. Rep. 1160, 1165 (K.B. 1758) ("Suppose, just before, and in contemplation of an intended bankruptcy, such a deed, of all of his effects, was made, and possession instantly delivered [to pay the debts of favourites] this . . . must be unjust, if not corrupt."). Creditor equality breaks down this "status" relationship and encourages purely abstract creditor entities to compete for collection even without the sunk costs in pre-existent power. Rosenfeld, *Affirmative Action, Justice, and Equalities: A Philosophical and Constitutional Appraisal*, 46 OHIO ST. L.J. 845, 852 (1985) [hereinafter Rosenfeld, *Equalities*] ("Moreover, by placing the postulate of equality within its proper historical perspective, one is reminded that it first emerged as a moral weapon against the privileges of status and birth characteristic of the feudal order."); see also Carlson, *Rationality, Accident, and Priority Under Article 9 of the Uniform Commercial Code*, 71 MINN. L. REV. 207, 213-30 (1986) (developing a theory on the anonymizing norms in commercial law); Carlson, *Simultaneous Attachment of Liens on After-Acquired Property*, 6 CARDOZO L. REV. 505, 519-20 (1985) (arguing that creditor diligence is descriptive, not normative); Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 98 (1986) (bankruptcy equality favors distant creditors over local creditors).

These comments suggest that a creditor's "job" is not to maximize recovery through a non-consensual grab. Rather, the creditor is expected to share when the debtor is insolvent in a sort of anti-feudal gesture toward a market ideology. See Weisberg, *supra*, at 88 ("when instead American bankruptcy law aggressively took on the spirit of equality as equity, the suppressed moral questions about bankruptcy shifted to the creditor's collegial duty to uphold this rather abstract collectivist spirit"). Bankruptcy, then, becomes the primary (but not the only) institution designed to force creditors to share with other creditors. It is a communitarian, rather than a self-interested, regime. It tells the creditor that he is going to share equally with his fellows whether he likes it or not.

I do not mean to suggest that law has immanent rationalities, or that anonymization of creditor rights is per se desirable. See Shuchman, *An Attempt at a "Philosophy of Bankruptcy"*, 21 UCLA L. REV. 403, 446-48 (1973) (finding moral worth in status relations). I only wish to suggest that equal priority may be a normative idea put in place to confirm desired creditor conduct, rather than the product of what creditors really want separate from law. It is too late in legal scholarship for anyone to suggest seriously that human desire is always prior to and determinative of the law. Law is just as likely to inform human preference as vice versa.

44. See Dworkin, *supra* note 7, at 19, 37.

tremely unrealistic and ahistoric caricature of creditors. Given that fact, Jackson might as well have made his utilitarian claim straight off (although, as we have seen, even *that* claim is pretty dubious). If he had followed this advice, he could have limited his efforts to showing that a majority of people (or people with a majority of the utility) would prefer equal priorities in bankruptcy.⁴⁵

At least where externalities are not produced,⁴⁶ efficiency implies that subgroups unhappy with the efficient law could contract for their own maximizing rule.⁴⁷ But when the parties are not permitted to change a bankruptcy rule by contract, efficiency cannot easily explain the rule without abandoning a faith in the sovereign individual.

Debtors in bankruptcy have a more or less unwaivable right to a bankruptcy discharge.⁴⁸ That is, consumers who do not prefer to preserve discharge rights are nevertheless prevented from contracting them away. Accordingly, Jackson must abandon efficiency — at least of the naïve “sovereign consumer” sort — as the norm that justifies bankruptcy discharges. Instead, Jackson uses what he calls a “Rawlsian” mode of justification (pp. 236-37).

The shift from efficiency claims to Rawlsian claims is totally unjustified in Jackson’s book. Why should creditor priorities have a utilitarian basis, while bankruptcy discharge must have a basis in neo-Kantian transcendentalism? A competent philosopher is supposed to develop *consistent* systems.

The reason that Jackson reverts to unacknowledged ad hoc shifts in ethical theories, I suspect, is to preserve the illusion that he has discovered a *single* deep structure of bankruptcy in contractarianism. That is, the language of hypothetical contract can always be used for efficiency arguments and it can also be used by Rawlsians to establish the transcendental quality of an ethical proposition. This common vocabulary is supposed to lull us into thinking that Jackson has revealed an important discovery of something embedded within the Bankruptcy Code.

If it is correct that contractarianism is not itself an ethical theory, Jackson substitutes word play for real philosophy. Because the vocabulary of contract in fact masks radically different ethical systems that contradict each other, we might briefly review some of the ways

45. *Id.* at 43 (veto power of individuals inconsistent with utilitarian theory).

46. Assuming there are ever such moments. Given the facts that (a) we take an intense interest in what our neighbors are thinking and feeling, and that such feelings must count in a utilitarian model with integrity, and that (b) any given contract affects the ability of the parties to make other contracts elsewhere, thereby shifting the demand curves any offeror faces, it may be that externalities are always present when two parties contract.

47. Creditors in bankruptcy do in fact have the opportunity to contract out of equal priority. See Carlson, *A Theory of Contractual Debt Subordination and Lien Priority*, 38 VAND. L. REV. 975 (1985).

48. The limited scope of the debtor’s power to waive bankruptcy discharge is described in 11 U.S.C. § 524 (a)(1) (1982).

Rawls' liberal individualism in *A Theory of Justice* contrasts with utilitarianism.

First, utilitarianism is majoritarian and hence communitarian in nature. It seeks to maximize aggregate human happiness by consulting the wants and needs of actual individuals, thereby mimicking liberal philosophy in this regard. But once a policy has been approved on utilitarian grounds, the minority that loses is expected to sacrifice itself for the good of the majority. It is just this illiberal (communitarian) feature of utilitarianism that Rawls is trying to avoid. In searching for *universal* principles, Rawls insists that the hypothetical consent be completely unanimous. A majority vote will not do!⁴⁹ This is no impediment, however. Since contractarians simply dream up the abstract human attributes needed to produce a unanimous agreement to a given proposition, it should be an easy matter to rig any model to produce unanimity by acclamation.⁵⁰

Rawls freely admits that his model will always yield unanimously consenting individuals.⁵¹ This brings us to a second important difference between utilitarian and Rawlsian contractarianism. Utilitarians pretend to be neutral about what to do; they then go out into the world and, on the basis of empirical research, discover whether a given program increases aggregate happiness in the world. Rawls, in contrast, is no determinist. He already knows exactly what programs he prefers — essentially, the war-on-poverty-style welfare state that was still popular in the early 1970s. He then undertakes to find the philosophy that universalizes these preconceived intuitions.⁵²

49. See J. RAWLS, *supra* note 8, at 11-12; Rosenfeld, *Contract and Justice*, *supra* note 5, at 868.

50. See Countryman, *supra* note 1, at 827.

When Jackson's chapters on bankruptcy discharge first appeared as an article in the *Harvard Law Review*, Jackson thought he was making a Rawlsian argument if he could show "that most people would choose to retain a nonwaivable right of discharge if they knew of the psychological factors that tempt them to overconsume credit." Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1394 (1985) (emphasis added). Admirably, Jackson, in his book, is merely ambiguous on whether unanimity is important or not. The only place where he concedes that nonunanimity could exist is a place where he seems to slide (without warning us) into an efficiency argument. P. 241. Therefore, it is possible (although somehow I doubt it) that Jackson understands the significance of unanimity in Rawlsian arguments.

51. J. RAWLS, *supra* note 8, at 139-40; see Pence, *supra* note 10, at 147 ("since there is no possibility of conflicts of interest, there is no possibility of non-unanimity"). For the view that the veil of ignorance was not even necessary to produce unanimity of agreement (in light of the presupposed equality of the bargainers), see Nagel, *Rawls on Justice*, 82 PHIL. REV. 220, 225 (1973).

52. See, e.g., J. RAWLS, *supra* note 8, at viii ("Of the traditional views, it is [contractarianism], I believe, which best approximates our considered judgments of justice and constitutes the most appropriate moral basis for a democratic society."), *id.* at 4 (wishes to see if intuitive notions of individualism can be accounted for), *id.* at 141 ("We want to define the original position so that we get the desired solution."), *id.* at 166 ("one of the main problems of justice as fairness [is] to define the original position in such a way that, while a meaningful agreement can be reached . . . the constraints imposed . . . still lead to principles characteristic of the contractarian tradition"). See Hare, *supra* note 12, at 83-84 (describing Rawls as an intuitionist); Stick, *Can Nihilism Be Pragmatic?*, 100 HARV. L. REV. 332, 377 (1986) ("For Rawls and Dworkin, moral

This is not to say that Rawls' philosophy is useless or unsuccessful. Rawls argues that the contractarian model has a role to play within an intuitionist system whereby we are led to question our views within the context of a reflective equilibrium.⁵³ Robert Paul Wolff points out that the assumptions introduced by Rawls in hypothesizing unanimous consent successfully describe what it means for a person to take the "moral position." That is, the "moral position" requires that we pretend to be ignorant of the contingent facts of our situation in life.⁵⁴ Rawls' technique is to discover what kind of human being it would take to agree unanimously about the fundamental institutions underlying his own predispositions. If the resulting portrait of essential human qualities is attractive, Rawls knows that his beliefs have been justified on universally applicable principles.⁵⁵ If not attractive, Rawls knows that his preferences are in "reflective disequilibrium."⁵⁶

intuitions come first, theories are then built to explain a group of intuitions we feel strongly about, with the grand theory checked against other intuitions.").

53. See Dworkin, *supra* note 7, at 27-37 (criticizing the usefulness of contractarianism for this purpose).

To the extent Rawls explores his own preconceived intuitions in a state of reflective equilibrium, use of words such as "universalize" has to be taken in a specialized sense. Rawls, of course, never reaches universals in the sense of asserting them as true in all times and contexts. If he did, there would be no need for reflective equilibrium between potential universals and preconceived intuitions. Rawls has made such thoughts explicit in a recent article. Rawls, *Justice as Fairness: Political Not Metaphysical*, 14 PHIL. & PUB. AFF. 223 (1985).

54. R. WOLFF, *supra* note 30, 61-64. Wolff presents a rather detailed history of why Rawls is so free to admit the dependence of his philosophy upon the preferred outcome. According to Wolff, Rawls, in 1958, had presented a contractarian theorem without the "veil of ignorance." Critics then hammered away at Rawls, pointing out that people of different talents would not necessarily come to bargains even on the basic principles posed by Rawls. Thereafter, Rawls dedicated his career to the rehabilitation of his 1958 article. Thus, Rawls abandoned the idea that the hypothetical contract "explained" the institutions of society. Instead, he simply presented the assumptions of the hypothetical bargaining session needed to produce the result he sought — reaffirmation of the basic institutions in a liberal welfare state. *Id.* at 3-4, 57-65. Wolff comments somewhat slyly:

Now, it is perfectly sensible to treat a set of words [such as Rawls' 1958 article] in this manner if they come to us with some stamp of authority — if, for example, they are the words of God. When reason conflicts with the apparent meaning of God's commands, one natural (although not the only) response is to interpret the command. One cannot simply change it, since it is God's word, but one can cast about for a meaning conformable to reason and moral intuition. The same sort of procedure makes some sense when one is dealing with the writings of a great but obscure thinker. Some philosophers on occasion have deep insights that are rich in suggestion and promise, but whose expression is obscure or confused But there is something slightly odd about a philosopher treating his own words in this manner. Surely, we want to say, Rawls should either decide that his original solution to the bargaining game was correct, and defend it, or else decide that it was wrong, and change it. But why decide that it was wrong, and then split the difference by sticking with the words and changing their meaning?

Id. at 878-79.

55. See Yablon, *supra* note 9, at 878-79.

56. Jackson, in contrast, does not explicitly state that he openly embraces a system whereby he first identifies his own personal prejudices and then works backward to find the universal principles that justify them. Nevertheless, given the fact that the basic bankruptcy status quo almost always escapes unscathed in Jackson's book, Jackson does seem to be in the Rawlsian tradition of cooking the results of his thought experiments (albeit not consciously).

Rawls' desire to discover universal principles leads to a third distinction between utilitarianism and Rawlsian contractarianism. Utilitarians love tiny, historically situated problems. Indeed, they cannot deal with anything else. What individuals want is a function of their wealth; any proposal to change a metainstitution would also change what individuals want, thereby leading to a serious indeterminacy.⁵⁷ In contrast, Rawls specifically limits his contractarianism to the justification of only the most basic institutions — such as the political equality or economic inequality of the individual. Such a limitation is necessary in order to render Rawls' abstracted, unanimously consenting humans still plausible to us.⁵⁸ Rawls believes that, as ethical propositions become more and more contingent on the facts of society, "second best" fairness arguments can be effective tools of justification that will break down the likelihood of unanimous consent.⁵⁹ Rawls has been sharply criticized for keeping his theory insulated from knock-about microeconomic issues in which our moral intuitions are likely to be the strongest.⁶⁰ But Rawls' abstractness is virtually dictated by the fact that in ethics, as elsewhere, two wrongs often *do* make a right.⁶¹

The above observation should suggest that in justifying a tiny little institution like the bankruptcy discharge Jackson cannot invoke the prestige of John Rawls to protect his argument. In a universe detailed enough to have creditors, debtors, and bankruptcies, human beings already have so much historicity attributed to them that unanimous agreement about bankruptcy discharges can only be achieved by producing a distorted and unrealistic portrait of human nature.⁶²

Rawls' ahistoricism leads to a fourth distinction between utilitarian and Rawlsian contractarianism. Utilitarians constantly invite individuals to calculate preferences between present and future con-

57. On wealth effects as a pervasive source of indeterminacy in law-and-economics, see Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387 (1981). Kennedy is attacked in Markovits, *Duncan's Do Nots: Cost-Benefit Analysis and the Determination of Legal Entitlements*, 36 STAN. L. REV. 1169 (1984); and defended in Carlson, *Reforming the Efficiency Criterion: Comments on Some Recent Suggestions*, 8 CARDOZO L. REV. 39, 52-58 (1986).

58. See Rosenfeld, *Contract and Justice*, *supra* note 5, at 817.

59. See J. RAWLS, *supra* note 8, at 57. Mark Tushnet put it very well: Moral philosophy, in its present state, can only rely on objective values that are so abstract that they cannot provide normative guidance in real cases. A theory of justice in a world with serious imperfections is undeveloped in the literature and might help. I would bet, however, that a philosopher's theory of the second best would establish that moral philosophy alone must remain insufficient. Tushnet, *Legal Scholarship: Its Causes and Cure*, 90 YALE L.J. 1205, 1213 (1980).

60. R. NOZICK, *supra* note 31, at 204-06 (1974). Nozick errs, however, in supposing that Rawls dismisses micro issues as "unimportant," *id.* at 206-07, and fails to see that Rawls worries about valid second-best concerns in microethical issues.

61. See J. RAWLS, *supra* note 8, at 57.

62. In the next section, we'll see that Jackson does produce an abstract portrait of a consenting human being that is indeed unrealistic.

sumption. Rawls bars any probabilistic knowledge from the original position.⁶³ Instead, his unanimously consenting persons assume conservatively that they should approve political proposals on the assumption that each will be dealt the absolute worst position in society when the veil of ignorance is lifted.⁶⁴ The abolition of probabilistic knowledge seems vitally necessary to distinguish Rawlsian contractarianism from utilitarianism. If people knew the odds of winning and losing, they might well vote to "take a chance" and would end up approving *any* proposal that produced an efficiency gain.⁶⁵

A fifth distinction between utilitarianism and Rawlsian contractarianism is that utilitarianism accounts for altruistic preferences in the world.⁶⁶ Rawls, on the other hand, attempts to base unanimous consent on the self-interested individual.⁶⁷ Here, at least, Jackson adopts a genuine Rawlsian trait. He too seems interested in basing hypothetical consent on self-interest.⁶⁸

For at least these five reasons, Jackson needs to justify why utilitarian contractarianism is used in part of his book and abandoned in the chapters on bankruptcy discharges. His failure to explain this switch in ethical theories renders his philosophizing about bankruptcy *ad hoc*.

2. Jackson's Theory of Personality

Jackson bases both his utilitarian contractarianism and his Rawl-

63. J. RAWLS, *supra* note 8, at 155.

64. *Id.* at 152-53.

65. R.M. Hare accuses Rawls of hiding in lofty abstractions because otherwise Rawls' contractarianism leads directly to utilitarianism. Hare writes:

We can, indeed, easily sympathize with the predicament of one who, having been working for the best part of his career on the construction of "a viable alternative to the utilitarian tradition," discovered that the type of theory he embraced, in its simplest and most natural form, led directly to a kind of utilitarianism.

Hare, *supra* note 12, at 91 (citation omitted).

66. I say this with full knowledge that most economics is practiced on the strength of the profit-maximizing assumption. This assumption badly distorts genuine utilitarian calculations. See generally Harrison, *supra* note 33.

67. J. RAWLS, *supra* note 8, at 183-92.

68. At one point, Jackson states that he is interested in producing a *systematic* theory of bankruptcy discharges. He does not define what makes a theory systematic. He does, however, criticize Anthony Kronman for being nonsystematic in revealing a competing truth embedded in bankruptcy discharges. See pp. 233-34. Kronman has deduced that bankruptcy discharges prevent people from feeling regret, see Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983), a theory that presupposes altruistic feelings toward others. I *think* (but I'm not sure) that Jackson views altruism as an insufficiently stable basis for explaining bankruptcy discharges (in comparison to self-interest). Therefore, I take "systematic" to mean "always present in the human personality" and a "systematic theory" to be one that shows that people prefer bankruptcy discharges based on self-protection. See p. 233 ("Rather, in order to justify nonwaivability, it must be shown that individuals *systematically* misjudge (or ignore) their own interests and that this bias consistently leads them in one direction — to consume too much and save too little."); p. 241 ("The preceding discussion suggests that what seems initially to be a paternalistic justification for discharge may in fact be consistent with society's preference for individual autonomy.").

sian contractarianism on an abstract person bent on maximizing her self-interest. But, as we have seen, utilitarianism and Rawlsian contractarianism are radically contradictory ethical theories. Within his discussion of self-interest, Jackson engages in a major shift in his theory of personality. In the creditor-priority model, Jackson's human beings were completely rational calculators. Human beings in his chapter on bankruptcy discharges suddenly become more complex (although equally as unbelievable). They modulate between cupidity, stupidity, and lucidity in a most unpredictable manner. Jackson completely fails to explain why (or even notice that) people have different attributes in different parts of the book.

Even putting aside this enormous inconsistency, Jackson's theory of the personality that prefers bankruptcy discharge is most unconvincing. Jackson starts off by promising to expose a universal human trait that renders the bankruptcy discharge desirable to all people⁶⁹ (although he ends up not delivering). He identifies two departures from the rational calculator that supposedly justify equal priority in bankruptcy: (1) the impulsive, noncalculating desire to go on a buying binge,⁷⁰ and (2) incomplete information about the future. Careful reading of Jackson's book will reveal that Jackson does not intend these to be universal traits, however. It turns out that only some of us suffer from these traits, so that there is no "systematic" human failure after all.⁷¹ I don't think Jackson is close to making his case for these predicates, in either the universal or nonuniversal versions. Furthermore, we will see that Jackson's insincerity about his bounded theory of personality — his unwillingness to assert that we all are congenital binge buyers or bad prognosticators — causes Jackson, right in the middle of his so-called Rawlsian argument, to modulate between liberal individualism and utilitarianism.

a. Impulse buying. Jackson claims that *some* (all?) people have "impulse" personalities. Jackson is not completely insensitive to the charge that what we call a person's "impulse" the person might call her own "rational" preference for present consumption over future consumption (pp. 242-43). After all, throughout most of Jackson's book, the consumer is sovereign and is entitled to his autonomy as both a prudential and ethical matter.⁷²

69. The problem cannot be simply that people come to regret some of their actions because they or their circumstances have changed over time. Rather, in order to justify nonwaivability, it must be shown that individuals *systematically* misjudge (or ignore) their own interests and that this bias . . . leads them to consume too much and save too little. P. 233 (emphasis in original).

70. "When presented with a choice, individuals tend to choose current over postponed gratification, even if it is known that the latter holds in store a greater measure of benefits." P. 234.

71. Although Jackson is quite vague on whether impulse behavior is universal in human beings, numerous passages are designed to deal with the problem that not everyone suffers from impulse buying. See pp. 236, 241-43.

72. Autonomy is prudential, Jackson thinks, in that we do not have the technology to tell the

The difference between the sovereign consumer and the impulsive individual is defined by the impulsive person himself, according to Jackson. The impulsive person wants protection against the impulse and hence wants the bankruptcy discharge.⁷³ The discharge (Jackson claims) has the effect of making credit unavailable today, thereby removing a person from danger.⁷⁴ Thus, anyone who wants the bankruptcy discharge *for himself* shows himself to be an impulse buyer. Indeed, this declaration is, apparently, the only evidence available to distinguish rational from irrational behavior.⁷⁵

That *some* people want bankruptcy discharges for themselves does not answer (and is not intended to answer) why we all must take or not take the discharge as a group. Why should the great majority suffer the "loss" of credit opportunities because a few addictive personalities will abuse the privilege? Jackson's response is to fall back on Rawls:

This kind of rule is justified by [a] hypothesized Rawlsian original position . . . : if the members of society had gathered together before the fact and had anticipated the human tendency toward impulsive behavior,

difference between rational calculation and impulsive behavior. Only the individual can tell us that, says Jackson. Pp. 242-44. Autonomy is also stated to be an a priori good at various points as well. P. 240-41 ("Framing the problem this way allows us to see how a system premised on individual autonomy can accommodate certain socially imposed restrictions on activity that are commonly deemed paternalistic."). See also Jackson, *supra* note 50, at 1404 ("much of American society in general[] is structured around the premise that individuals should for the most part [note the fudge word] have the freedom to order their own affairs as they please").

Such concepts as "maximizing autonomy" (in the non-Kantian sense of freedom from dependence on or interference from others) are usually dismissed as indeterminate or incoherent in that they do not have enough content to mediate between admittedly conflicting desires of different human beings. One particularly interesting essay is Kennedy & Michelman, *Are Property and Contract Efficient?*, 8 HOFSTRA L. REV. 711 (1980). Kennedy and Michelman put forth the thesis that there is a law of conservation of security, whereby one person's "freedom" is expanded only at the expense of shrinking someone else's. They would view the concept of "maximizing autonomy" (quite correctly, in my view) as a meaningless statement.

None of these concerns bothers Jackson, however, who assumes that he has said something when he asserts that America loves autonomy. America loves brotherhood, patriotism, and prayers in school. These concepts don't have the slightest thing to do with personal autonomy and in fact are antithetical to it.

73. If unrestrained individuals would generally choose to consume today rather than save for tomorrow, and if this tendency stems in part from impulse, they may, given the chance, opt for a way of removing or at least restricting that choice in advance. If individuals cannot control the impulse themselves, they may want the assistance of a socially imposed rule, one that will simply enforce the hypothesized decisions of their fully rational selves.

P. 235.

74. "[The] tendency of individuals to impose external restraints on their impulses provides a basis for deciding which of an individual's personalities to favor The control of impulsive behavior, then, may provide a key insight on the road to justifying discharge policy." P. 235. Note the emphasis on the decision of the restrained individual as the basis of justification. Jackson wants to deny that bankruptcy discharges are paternalistic and wants to substitute a self-paternalistic justification.

75. "When society attempts to distinguish individuals who act impulsively . . . from those who do not, it runs the grave risk of substituting an external social judgment for the subjective wants and needs of the individual." P. 242.

they would have devised a rule that *denied them the opportunity* to behave impulsively in the future. [pp. 236-37; emphasis added].

This leap from "some people want self-protection from their contracts" to "we all want self-protection" is presumably based on Rawls' convention that, behind the veil of ignorance, each person does not know whether she will be dealt the defective binge-buying personality⁷⁶ and must therefore bargain as if she will be the binge-buyer.⁷⁷

Please note that, in the original position, we would *all* agree that *all* contracts are ultimately nonbinding,⁷⁸ because we are systematically (or perhaps randomly) too impulsive to take responsibility for our future. This Rawlsian argument is a complete self-contradiction, unless Jackson abandons the claim that we each have an uncontrollable impulse within us. How can contract be the basis of society when human beings are systematically too incompetent to contract? Instead, the binge-buying impulse must be in the nature of learned behavior, or perhaps a disease. Otherwise, Jackson could not practice his contractarianism at all.⁷⁹

Be that as it may, Jackson's argument that binge-buyers want the

76. Cf. J. RAWLS, *supra* note 8, at 137 ("no one knows . . . the special features of his psychology such as his aversion to risk or liability to optimism or pessimism"); *id.* at 172 ("[T]he parties do not know whether or not they have a characteristic aversion to taking chances."). Rawls would also insist that the folks in the original position be ignorant of the exact odds of being in one group or the other. *Id.* at 155.

77. This is the so-called "maximin" bargaining strategy. J. RAWLS, *supra* note 8, at 152-56.

78. After all, bankruptcy discharge and freedom of contract are completely at war with each other.

79. Jackson does attempt a possible strategy to rehabilitate the pervasiveness of binge-buying tendencies: Reason is to be disembodied from the impulsive personality, and it is possible in the original position to consult the disembodied reason (or noumenal self) separate from the rest of the personality (or phenomenal self). Jackson writes:

This tendency of individuals to impose external restraints on their impulses provides a basis for deciding which of an individual's personalities to favor. One personality is the rational planner; it carefully assesses the relative merits of current versus future consumption. . . . The impulse personality does not authentically choose because it does not rationally ponder how a given decision will affect the individual's long-term interests.

P. 235. Cf. R. WOLFF, *supra* note 30, at 103-04 (interpreting Rawls to be attempting such a strategy).

The problem with such a strategy is that Jackson is no longer consulting the preferences of human beings but is simply consulting (somebody's) principles of reason. Such a strategy abandons neutrality about the good, and substitutes subjective notions about what is reasonable.

One way to keep actual human personalities in the consent scheme (and thereby staying relatively neutral about what is good) is to characterize impulsive behavior as learned behavior, and not part of the human personality at all. That way, *genuine* human beings can be placed in the original position (before they pick up bad habits), instead of disembodied reason.

But if impulsive behavior is learned and not genetic, it certainly suggests that people could "learn" to control their impulses. See p. 235 ("The rational self, to the contrary, suppresses the temptation to act impulsively . . ."). Once that is admitted, Jackson needs to explain why people in the original position would agree to repeal the discharge in order to encourage the rational self to control the irrational self.

Rawls views self-paternalism as a principle that may be adopted from the original position: [O]nce the ideal conception is chosen, they will want to insure themselves against the possibility that their powers are undeveloped and they cannot rationally advance their interests, as in the case of children It is also rational for them to protect themselves against their own irrational inclinations by consenting to a scheme of penalties that may give them a

discharge *for themselves* is also rendered confusing by his false assumptions about the effect of the bankruptcy discharge. Jackson assumes that the discharge will "control" the binge-buying impulse "by encouraging creditors to monitor borrowing."⁸⁰ Here Jackson implies that creditors will withhold credit altogether as a result of monitoring.

This does not follow for at least two reasons. First, Jackson's dichotomy between "rational" *creditors* and potentially irrational *borrowers* is a false one. Why are all creditors rational, while all irrational people end up as debtors? Extending bad loans can be a form of binge-buying, as any bank failure will demonstrate. In short, Jackson fails to account for the fact that perhaps creditors will make mistakes in controlling debtors' credit habits.

Second, Jackson is quite unrealistic in imagining that rational creditors will withhold credit from binge-buyers.⁸¹ Creditors may be unable to recognize the good borrowers from the binge-buying maniacs. They may choose to increase the cost of credit to everyone, collecting the lost principal from the interest charged to the "rational" buyers and the irrational-but-lucky bingers. Please recall that Jackson believes that we can never objectively tell whether a buyer rationally prefers present over future consumption and that we depend upon the debtors themselves to tell us they are binge-buyers by declaring, "I want an unwaivable bankruptcy discharge and I want it *for myself*." If such declarations are the *only* way we can separate out rational from irrational behavior, then "monitoring" must consist of creditors asking prospective borrowers whether they are uncontrollable binge-buy-

sufficient motive to avoid foolish actions and by accepting certain impositions designed to undo the unfortunate consequences of their imprudent behavior.

J. RAWLS, *supra* note 8, at 248-49. Note that Rawls sees his system as indeterminate about issues like bankruptcy discharges. That is, he sees that it is reasonable to agree to repealing the discharge (in order to provide incentives to control the impulse) or instituting the discharge (to undo the unfortunate consequences of their folly). Jackson, on the other hand, certainly implies that bankruptcy discharge is the one and only rational response to the uncontrollable impulsive personality.

80. P. 236. See also p. 249. "Controlling" the impulse itself must be distinguished from protecting the debtor from the long-term consequences of the uncontrolled impulse. Jackson clearly means that the discharge will render impulsive borrowers unable to borrow.

81. It by no means follows that creditors will always feel that discharges interfere with their chances of recovering the principal of a loan. Suppose the borrower has wealth but no important job prospects. If the borrower goes bankrupt, he will have no wealth. The bankruptcy discharge would have little to do with the credit decision in this case, because the creditor can expect no garnishable income to be earned after bankruptcy.

Another absurdity in Jackson's assumption is the clear implication that with the bankruptcy discharge the impulsive buyer is unable to borrow, but that *without* the discharge the rational creditor will gladly lend to a binge-buyer. If this is so, it must be because the lender knows he can always garnish future wages.

There is a big logical hole in this assumption. Only a maximum of 25% of wages can be garnished in this country. See note 95 *infra*. If the binge-buyer continues his profligate ways, the future wages are constantly subject to garnishments from other "prudent" lenders. As a result, future wages are lousy collateral and not sufficient to justify a loan to the binge-buyer. Hence, lenders *already* have an incentive to monitor the debtor and do not need the bankruptcy discharge to provide the incentive to do so.

ing maniacs. Now what do you suppose the typical binge-buyer is going to say (having already succumbed to the dark forces of unreason and asked for a loan)? I think it is fair to assume that at least *some* of the irrational binge-buyers are going to lie and say that they are not bingers at all. As a result, monitoring will fail to identify the bingers. They will be lumped in with everyone else.⁸² That means everyone gets credit, but at a higher price. So long as credit remains available at a higher price, the discharge, if anything, worsens the short-term effect of the binge-buying impulse by driving the debtor into bankruptcy earlier than if interest rates were lower. Therefore, it is wrong to premise the argument on discharge as "controlling" the impulse, unless Jackson is serious that the creditors will withdraw credit altogether. Rather, the discharge protects a person from *long-term* suffering because the impulse is in fact uncontrolled.

Another thing that must be said about this alleged binge-buying impulse is that Jackson obviously views it as a type of insanity that cannot be controlled. That is, no type of incentive will cause the rational side of the personality to increase its strength against the irrational side. This claim is central to Jackson's entire analysis; if punishments succeed in strengthening the resolve of the rational personality to squelch the irrational personality, then the bankruptcy discharge is counterproductive. Carried to its extreme, Jackson's argument — that our impulses cannot be controlled — delegitimizes all modern criminal law and tort theory, which rest fundamentally on the premise that people's behavior *can* be influenced by punishments.

Jackson cannot simultaneously practice law-and-economics and also believe that the incentives produced by the law are worth nothing. Rather, he must view binge-buying as a "special" (*i.e.*, nonsystematic) case, like the insanity defense in criminal law. Jackson implicitly admits this when he states that it is "too costly" to separate out the sane from the insane, and hence we are all presumed insane:

A nonwaivable right of discharge may be desirable even if some individuals do not need its protection, as long as (1) a substantial number of people are likely to experience unanticipated regret as a result of impulsive behavior or unwitting reliance on incomplete heuristics and (2) it is either impossible or extremely expensive to distinguish those who will experience . . . regret from those who will not.⁸³

In the above quotation, Jackson has, without announcement, switched from a "Rawlsian" argument back to an efficiency argument.

82. Although Jackson implies credit will be withheld altogether from binge-buyers, he assumes elsewhere that credit will still be available but at a higher price. See p. 246 ("To be sure, Creditor will pass at least some of the additional costs back to Debtor in the form of higher interest charges; to the extent that Creditor does so, Debtor will internalize the costs and there will be no externality."). I wish I had a dollar for every inconsistency in this book.

83. P. 241. Presumably, with regard to crimes more serious than stiffing a creditor, it is no longer too costly to distinguish the sane from the insane. At least I hope so.

Jackson makes empirical assertions — large numbers of bingers and high costs of screening — that are quite irrelevant to Rawlsian justification. The efficiency argument therefore depends on being able to distinguish binge-buying from rational behavior and on identifying the screening costs⁸⁴ (which Jackson deduces must be high solely from the fact that the statute does not follow his theory).⁸⁵

Now, *if* there are really uncontrollable spendthrifts out there, Jackson can go ahead and make his Rawlsian argument on their behalf. But he cannot make his efficiency argument without adding in another important factor. One thing Jackson completely leaves out is that the discharge itself transforms binge-buying from irrational to rational behavior. Or to put it another way, the discharge itself might in fact encourage the very behavior that Jackson supposes the discharge squelches.⁸⁶ Surely the diseconomies of strategic binge-buying in anticipation of bankruptcy must be added to Jackson's cost-benefit analysis.

Here Jackson faces a serious circularity problem. Are people binge-buyers and hence there's a discharge, or are people binge-buyers *because* there's a discharge? In fact, it is impossible to determine whether law is a product of human desire or whether human desire is a product of law. Once civilized, it is impossible to imagine what we would want if we had no civilization, because our desires are formed by civilization.

To summarize, Jackson attempts to isolate a phenomenon of uncontrollable impulsive behavior and then connect it to the existence of the bankruptcy discharge. The attempt, however, is completely botched. His method of isolating those with a propensity to binge from rational calculators depends entirely upon self-identification.

84. Here, Jackson claims it is too costly and intrusive to distinguish the rational from the irrational borrowers and that it is cheaper to give everyone the discharge and presume everyone irrational. See pp. 241-42. But elsewhere Jackson presumes creditors can "monitor" debtors and foreclose the bingers from credit altogether. See p. 236. It sounds to me as if the creditors of page 236 ought to be put to work on the screening of pages 241-42!

85. Jackson is very sly on proving that the alternative costs to bankruptcy discharge are really very high. In the end, he relies on the impossibility of knowing another person's utilities. "When society attempts to distinguish individuals who act impulsively or who rely on incomplete heuristics . . . it runs the grave risk of substituting an external social judgment for the subjective wants and needs of the individual." P. 242. This observation is supposed to convince us that, since the cost of telling the difference between those who need paternalism and those who don't is too high, it is better to have untrammelled paternalism for everyone. But if substituting our ideology for a debtor's own choice is an evil, then why have a bankruptcy discharge at all? Why not have *no* paternalism instead of universal paternalism?

Readers should not be fooled by this kind of sloganeering. Jackson set out to prove the costs of screening to be higher than the attribution of mental defects to specific individuals. He did not do so, rendering his efficiency argument totally unsubstantiated. Deducing high costs from the existence of the very law you are trying to explain is circular.

86. Jackson does recognize this at other parts of his book, whenever he writes about the incentives that non-neutral bankruptcy rules create. See text at notes 116-38 *infra*. He fails to see that this belief in incentives undermines his discovery that preventing impulsive behavior is the goal of bankruptcy discharge.

Yet the mode of self-identification — wanting the discharge for protection against impulse — is said to be a universal Rawlsian desire. This universal desire to destroy freedom of contract defeats Jackson's contractarianism generally and his justification of the discharge in particular. Finally, his explanation of discharges ignores the possibility that people can be influenced by the incentives of the law and that binge-buying might itself be a strategic reaction to the existence of the discharge.

b. Incomplete heuristics. In addition to binge-buying, Jackson also offers up a second flaw in the human personality — incomplete heuristics — that justifies the bankruptcy discharge. As with impulsive behavior, Jackson is evasive on whether this flaw is systematically present in human beings.

There are at least two versions of what "incomplete heuristics" could mean. First, it could mean that, holding constant the quantity of information relevant to future predictions, some people calculate well and some people calculate badly. This, of course, assumes the existence of an objective arithmetic of predicting the future, against which we can assess individual calculations. The existence of such an objective arithmetic violates the premises of classical liberalism: that only each individual can decide what is good for herself. According to the second version, "incomplete heuristics" could mean that it is impossible or too expensive to gather all the facts all the time, so that our calculations are inevitably bounded by budgetary concerns. This latter version seems more defensible, but, judging from the type of evidence Jackson marshals (individuals are generally too dumb to do probability calculations), he seems to have the former in mind.

Whatever Jackson's theory of incomplete heuristics is, it seems to stem from two anecdotes told by psychologists. These anecdotes are supposed to prove that all (some?) human beings are too incompetent to manage their futures when the facts are held constant. One anecdote is about picking poker chips out of one of two bags. One bag has mostly blue chips and one has mostly red chips. Of twelve samples, eight are red chips. People are then asked what are the odds that the chips came from the predominantly red bag. Most people, it turns out, choose seventy percent or eighty percent, but the real odds (on the numbers given) turn out to be ninety-seven percent.⁸⁷ The other example is the assertion that people don't realize that when a plan involves ten steps, each of which is, say, ninety percent successful, the plan has less than a thirty-five percent probability of being successful. Rather, they assume that success is almost certain to follow, because

87. P. 237 n.35. The example comes from Edwards, *Conservatism in Human Information Processing*, in *FORMAL REPRESENTATIONS OF HUMAN JUDGMENT* 17, 20-21 (B. Kleinmuntz ed. 1968).

each step has a high probability of being successful.⁸⁸

Now I will concede that if you give the public pop quizzes in statistics, untrained individuals will make mistakes and will not give the answers that the statisticians want. But can we deduce from this general statistical naïveté that each and every person in the world is likely to overmortgage the future? Statistical expertise is a learnable skill. It is possible to teach people how to pass pop quizzes (or so undergraduate professors assume). This kind of knowledge has nothing to do with the innate, genetic flaw in the human psyche that Jackson claims exists.⁸⁹ I don't know beans about the odds of picking blue or red poker chips out of a sack, but I am pretty confident that I can live within my means. These two threadbare little anecdotes about statistical ignorance in no sense prove that some or all people are too incompetent to plan their lives.⁹⁰

Now even if it were true that "most people" cannot rationally figure out how to match future income and future outflow, there are several other obstacles between this fact and the successful justification of the bankruptcy discharge. Since the Bankruptcy Code includes no distinction between good and bad calculators, Jackson must at a minimum show that bad calculators end up in bankruptcy more often than good calculators (for the mere fact of rational risk implies some rational failures). How can we distinguish between good and bad calculation?⁹¹ All we know is that (a) the credit transaction took place, and (b) repayment did or did not occur. These data do not prove whether the borrower calculated correctly or miscalculated. A person who repaid might have miscalculated and still have been lucky. A person who defaulted might have calculated correctly and been unlucky.⁹²

88. P. 239 n.40 (citing Tversky & Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1129 (1974)).

89. This point was inspired by some remarks made by Phillip Shuchman at a bankruptcy conference at Duke University, held on April 12, 1986.

90. See Tillers, *Mapping Inferential Domains*, 66 B.U. L. REV. 883, 932 (1986) ("We have things backwards if we say that we should devise models of rational inference and then try to make our inferential processes conform to them. The object of a theory of inference is to elucidate the logical properties of inferential techniques that actually work."). Jackson himself begs the question of whether the two little anecdotes prove his thesis. He writes that "[a]lthough none of this work directly addresses the risks of nonpayment in credit decisions, these hypotheses suggest that individuals will underestimate the risks inherent in repayment. Nonetheless, it would be useful to have this theory tested empirically by examining the effect of heuristic biases on credit decisions." P. 239 n.40. One would have thought that a "major" work published by the Harvard University Press would be just the place to develop the data necessary to ground bankruptcy law in the biological makeup of man. However, developing data bases is hard work. Making up hypothetical contracts is not. See generally Sullivan, Warren & Westbrook, *The Use of Empirical Data in Formulating Bankruptcy Policy*, 50 LAW & CONTEMP. PROBS. 195, 219 (1987) (examining difficulties legal academics face in gathering empirical data).

91. Since Jackson goes on at length about bad heuristics, I am supposing that he believes there is such a thing as good heuristics. This possibility must not be the same as "good result" since irrational perception of the risk presupposes that good calculators will sometimes be failures and bad calculators will sometimes be successes.

92. See A. D'AMATO, JURISPRUDENCE: A DESCRIPTIVE AND NORMATIVE ANALYSIS OF

Therefore, Jackson has given us a theory of bankruptcy behavior that is completely unverifiable.

Jackson's assumption that he can tell the difference between good and bad heuristics should be contrasted to his earlier pessimism about his ability to tell the difference between rational calculation and impulsive behavior. This pessimism caused Jackson to rely heavily on an individual's reportage that he favored the discharge *for himself*. If Jackson needs this manifestation to tell the difference between calculation and no calculation, how is it that he can tell the difference between bad and good calculation? I think the answer is that he can't and that this section of his book is a hopeless muddle.⁹³

3. *Noncontractarian Justifications of Bankruptcy Discharge: Externalities and "Welfare" Economics*

In the above discussion, I have argued that Jackson, without warning or justification, switches from utilitarianism to individualism (and back). Similarly, he changes his theory of the human personality, attributing to debtors motives that are totally different from the desire for profit maximization that creditors had. The ad hoc flavor of this reasoning is enough to cause us to reject it.

Jackson has two other "explanations" of the bankruptcy discharge that I cannot resist commenting on. One is based on bad economics and the other is based on even worse sociology. The economic claim is that the bankruptcy discharge prevents externalities. The sociological claim is that the bankruptcy discharge might help relieve the welfare rolls of deadbeat debtors (a claim that Jackson tentatively rejects after lengthy commentary).

a. *Externalities*. Putting aside a somewhat underdeveloped page about the need to protect love and friendship,⁹⁴ Jackson's theory of

LAW 22 (1984) ("a prediction expressed in terms of probability cannot be invalidated by the event that actually occurs").

93. Furthermore, what does it mean for an individual to calculate the odds of his future? There is no logarithmic table that tells you such data as, "There's a 13.8% chance you'll lose your job." That's just a lot of hooey that economists use to grease their mathematic models. In real life, this alleged calculation of the future seems to be no more than simply a feeling of confidence that is in no way quantifiable. The so-called calculation may not *cause* the credit transaction. The transaction may simply be driven by nonrational affects. The calculating consciousness that is (occasionally) experienced may be merely epiphenomenal. See A. D'AMATO, *supra* note 92, at 23 ("no matter how refined it is, on any given day a prediction of eighty percent rain for tomorrow is still only a measure of the degree of confidence of the predictor and cannot be invalidated by the fact that the next day the weather is sunny."). See also 1A J. WIGMORE, EVIDENCE § 37.6, at 1054-61 (P. Tillers ed. 1983) (describing Bayesianism in this vein).

I do not mean to say that all predictions are qualitatively equal. I simply wish to challenge the easy assumption that there is an exact calculus of historical prediction expressible as percentage chances. These numbers only express the strength of feelings in a very imprecise way.

94. See pp. 243-44. Briefly, Jackson worries about family and friends who rely on the debtor for psychological as well as financial support. Without discharges for the debtor, these people could suffer losses.

As to financial support, Jackson must have only nonobligatory gifts in mind, since legally

externalities produced by the bankruptcy discharge goes like this: (a) Even with garnishment protection, workers at the margin will quit their jobs if twenty-five percent of their wages⁹⁵ is garnished for the foreseeable future. (b) Workers usually produce a surplus beyond their wages, which belongs to the employers.⁹⁶ (c) This surplus guarantees that the public cost of garnishment (the cause of quitting) exceeds the private cost to the debtor.

There is something very wrong with this account. Why does Jackson assume that workers in debt will obviously quit their jobs? A lot of workers might take *second* jobs to keep up with their debts. And even if they do quit, where does this employer's surplus come from? Usually, it comes from competition on the wage front.⁹⁷ If there is no competition, there may be no surplus, because the worker is a monopolist who will have extracted the surplus for herself. On the other hand, if there is wage competition between workers, there is no loss of

binding family support is ultimately a nondischargeable claim. 11 U.S.C. § 523(a)(5) (1982 & Supp. III 1985). Any theory of inefficient gift-giving, however, must explain why distributions to relatives and friends produce more utility than distributions to creditors would. *See generally* Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. (forthcoming). It might be possible to do so, however, on "efficient income redistribution" grounds. *See, e.g.*, Markovits, *The Causes and Policy Significance of Pareto Resource Misallocation: A Checklist for Micro-Economic Policy Analysis*, 28 STAN. L. REV. 1, 4-5 (1975) (emphasizing that people have diminishing utility for marginal dollars).

As for psychological support, Jackson does not even begin to make his case. We all like to think that our friends will stick by us when we fall into debt, but there are a million aphorisms to the effect that friends tend to melt away when a person loses her wealth. But let's be generous and assume that friendship is a product that survives impoverishment and that friends really do suffer pain when the debtor does not obtain a discharge. The discharge does not preserve the debtor's wealth, of course. It eliminates debt which might otherwise be collected from future wages or future wealth. If friends feel pain, it must be unrelated to the loss of wealth (which is inevitable) and dependent upon the debtor's inability to accumulate wealth thereafter. If, however, friendship has survived present impoverishment, would it not survive future impoverishment also?

Let me add something else. Speaking only for myself, if a friend of mine went bankrupt, skipped out on his debts, and then took a lucrative garnishment-free job thereafter, my pain would not be dissipated. Quite the contrary. It would be the very source of pain. Skipping out of one's debts is ignoble in my book, while suffering the slings and arrows of outrageous misfortune is ennobling. Discharges can *cause* pain in some friends. In any case, if loss of friendship is a real concern, I doubt that Jackson is being very insightful when he states that friends and relatives can protect their interests by "negotiating" with a debtor over whether he should take credit risks. P. 243. Isn't this the same binge-buying debtor with bad heuristics referred to earlier in the book?

95. Federal law limits all wage garnishments to a maximum of 25% of wages, or 60% if the creditor has an alimony or child support claim. 15 U.S.C. § 1673 (1982). Since these latter claims are not dischargeable in bankruptcy anyway, 11 U.S.C. § 523(a)(5) (1982 & Supp. III 1985), we can simply refer to the 25% rule as relevant in the present discussion.

96. P. 245 ("collection actions will still produce negative externalities if the individual's wages prior to his substitution of leisure systematically *underestimated* the marginal value of his productive efforts") (emphasis in original).

97. It might also come from long-term employment contracts in which wage rates are locked in, where an employee with monopoly power guessed wrongly about the amount of surplus there would be for extraction. Unions, of course, aim at establishing and exploiting bargaining power and might similarly misestimate the amount of surplus, but, if the employer can replace a quitting union member with another just as good, no loss occurs in a union context either.

surplus as Jackson supposes, because the employer will simply go out and hire someone else.⁹⁸

Jackson's argument about social loss is quite incomprehensible, but it is so much fun that I think we should look it over rather carefully. Jackson writes:

Consider the case of a law professor. Assume that all law professors are suited equally to either teaching or practice and that the prevailing wage rates are set at a level that will attract the necessary number of law professors. . . . Assuming the prevailing salary of law professors to be \$75,000 a year and that of practicing lawyers to be \$150,000, the law professor at the margin will be enjoying \$75,000 of nonpecuniary benefits from his job. Because of the assumption of full substitutability of law professors for lawyers, the social benefit of the two jobs will be equal, notwithstanding the wage differential. But because wages can be reached by creditors whereas the other job benefit[s] cannot, a law professor faced with a lifetime of wage garnishment might switch to a job with a lower wage level but similar amounts of leisure and nonpecuniary benefits. Even though the lower absolute level of entitlements (wages plus leisure and nonpecuniary benefits) reflects a socially less productive job, the switch would be less costly to the law professor than it would be to society. [pp. 246-47]

Although the above analysis is truly rotten economics, it is anthropologically fascinating. First, note that Jackson asks us to assume that professors earn \$75,000 a year. Given such a salary, we can safely assume Jackson has a *tenured* professor in mind. It is well known that tenured law professors in America can and do whittle down their workload⁹⁹ to "a few hours a week thirty weeks a year."¹⁰⁰ The

98. See Whitford, *The Appropriate Role of Security Interests in Consumer Transactions*, 7 CARDOZO L. REV. 959, 969 & n.39 (1986). Even if Jackson is right that the surplus would inevitably be lost (which he's not), Jackson probably errs in calling the potential loss of surplus an "externality." P. 257. He definitely errs in supposing that higher interest rates charged by creditors in anticipation of the bankruptcy discharge will eliminate the "externality" of the worker imposing the "cost" of leisure on the creditor. P. 246 (leaving open the possibility that not all the externality is eliminated through higher interest).

I take an external cost to be a part of the marginal cost of production that a producer can pass on to the public. Externalities therefore lower the marginal cost of the producer below the "optimum" level and cause overproduction of the product in question.

Instead of describing garnishments as an externality, I would have said that the garnished worker is facing a cross-elasticity of supply between two potential products — work and leisure. The garnishment is a "tax" on work — not an externality resulting from leisure. The marginal tax pushes the worker toward nonoptimal leisure.

Meanwhile — and here's where Jackson definitely gets it wrong — the strategic reaction of a creditor to this "tax avoidance" — higher interest up front — would not solve the disincentive to choose leisure over work. The higher interest is a sunk cost, from the worker's perspective, by the time the worker must decide between working and goofing off. It can have no influence on the garnished worker and can only compensate the creditor in advance for expected losses. Therefore, internalization through higher interest rates up front is totally irrelevant to Jackson's thesis.

99. Jackson is careful to define "work" as that which a person must do to be paid. Leisure is "time spent on activities other than paying work." P. 247 n.59.

100. Ackerman, *The Marketplace of Ideas*, 90 YALE L.J. 1131, 1132-34 (1980); see also

thought that a tenured professor would quit such a job is truly fantastic. Many a dean wishes Jackson were right.

But look at Jackson's assumption! A tenured professor who has 25% of her wages garnished is going to switch to a new job with the *same* leisure and prestige and *less* wages? Where's the sense in that? For one thing, the new job will presumably be garnishable just like the old one. But even if it were not, what incentive does the professor have to take the dead loss that Jackson suggests? Putting aside a desire to spite the creditor, it seems to me that the professor is much better off staying put than taking the *same* leisure and *less* money elsewhere.

Finally, the thought that society suffers a deadweight loss because a tenured law professor quits is just laughable. The dean at the Harvard Law School needs to put Professor Jackson on the faculty appointments committee for a semester. I think Jackson would find it a revelation how many people are willing to fill a vacated professorship for a good deal less than \$75,000. I don't see the social loss if some tenured professor heads for the hills. Quite the opposite. If repealing the bankruptcy discharge could get rid of overpaid, underproductive, tenured law professors, then, far from proving the rationality of the discharge, Jackson has made the strongest conceivable argument for getting rid of it!

I don't think Jackson has shown that the social loss of an employee quitting his job is higher than the private loss to the employee. But even if this were so,¹⁰¹ Jackson has once again forgotten the Coase Theorem, which says that, absent transaction costs, the affected parties will simply bargain for an efficient solution. For instance, suppose there *is* monopoly power in the worker, such that if he quits his replacement would be an inferior worker. This could impose a loss on the employer. It also imposes a loss on the garnishing creditors. If transaction costs are low, the creditors, the debtor, and the employer could agree to split the difference, with the creditors taking less than their entitlement in exchange for agreeing not to garnish. The inefficiency caused by nondischargeable debt therefore does not depend at all on the existence of an employer surplus but is related to the transaction costs that must be incurred to keep a worker on the job.¹⁰²

b. Debtors on the dole. If Jackson's economic display fails badly,

Swygert & Gozansky, *The Desirability of Post-Tenure Performance Reviews of Law Professors*, 15 STETSON L. REV. 355 (1986).

101. William Whitford suggests a more sensible social loss if workers can be garnished. Workers are likely to be fired and suffer a loss of personal esteem as a result. Whitford, *supra* note 98, at 969. What I like about this suggestion is that Whitford is willing to concede this possible loss even though it is theoretically illegal to fire workers just because they have been garnished. See 15 U.S.C. § 1674(a) (1982). That is, sometimes the law that people follow is not the law that is on the books.

102. Jackson writes that his account "ignores such factors as the ability of Creditor and Debtor to agree to have only a portion of Debtor's wages garnished." Pp. 245-46. It sure does!

so does his suggestion that the discharge helps keep the welfare rolls clear. Admittedly, Jackson concludes (on inadequate reasoning) that this rationale is "incomplete." But Jackson gives it considerable credence: "If there were no right of discharge, an individual who lost his assets to creditors might rely instead on social welfare programs. The existence of those programs might induce him to underestimate the true costs of his decisions to borrow."¹⁰³

Such a thesis shows a fantastic ignorance of the American welfare system. In the United States, federally funded welfare programs are limited to the aged, blind, disabled, or single parents with dependent children.¹⁰⁴ In addition, states sometimes provide categories of aid to which the federal government does not contribute, but these programs infrequently apply to able-bodied people who can work.¹⁰⁵ The Food Stamp program provides some means for debtors to receive public support,¹⁰⁶ but even the Food Stamp program has a work requirement for able-bodied people.¹⁰⁷ Unemployment insurance requires that the bankrupt debtor contrive to get himself fired, but unemployment benefits are very short term.¹⁰⁸ In addition, the debtor must be prepared to work and is monitored constantly to make sure he is actively looking for work. It is safe to say, then, that the debtor who could work but refuses will find it hard to get welfare from the government.¹⁰⁹

If there is a connection between bankruptcy discharges and our welfare system, Jackson has not made the case. With our politics full

Since Jackson sees at least one refutation of his externality theory, one can wonder why he proceeds to present the theory anyway.

103. P. 231. In a truly heartbreaking passage, Jackson expresses his view that welfare encourages mountain climbing. "A person who breaks his legs while mountain climbing may be entitled to unemployment benefits, food stamps, health care, and the like. The knowledge that such assistance is available invites the individual to discount . . . the costs of possible future injury when deciding whether to climb." P. 231. Does Jackson really suppose that our welfare rolls are populated by crippled mountain climbers, or any class of people that is remotely analogous?

104. S. LAW, *THE RIGHTS OF THE POOR* 18-33 (1974). Even with regard to AFDC, able-bodied adults must register for the Work Incentive Program, unless they cannot do so because of child-rearing concerns. A narrow set of excuses for not registering are set forth in 45 C.F.R. § 224.20(b) (1986). The Reagan Administration has recently made it even harder for able-bodied parents to qualify for AFDC and has introduced "workfare" programs that force able-bodied welfare recipients to "earn" their welfare through uncompensated work. See S. LEVITAN, *PROGRAMS IN AID OF THE POOR* 37 (1985).

105. Sylvia Law lists twenty-one states whose general relief programs are limited to the unemployable. S. LAW, *supra* note 104, at 67-68. In other states, recipients must show that they tried to find work and were unsuccessful. *Id.* at 68. The awards are usually grants to meet needs specified by the recipient. *Id.*

106. See generally 7 C.F.R. § 271.1(a) (1987) (a purpose of the food stamp program is to enable low-income persons to obtain sufficient nutritious foods).

107. Certain people are exempt from registering for work, such as parents who must take care of their children, people under 18 or over 65, students, etc. 7 C.F.R. § 273.7(b) (1987).

108. Cf. S. LEVITAN, *supra* note 104, at 46-49.

109. See Simon, *Rights and Redistribution in the Welfare System*, 38 STAN. L. REV. 1431, 1463-64 (1986).

of base canards and false assumptions about politically vulnerable welfare recipients, it seems inexcusable that Jackson would float a major sociological theory about welfare without even lifting a finger to do some basic research on the question. In any case, it seems a fair assumption that able-bodied workers who prefer to quit their jobs if garnished will turn to the underground economy long before they apply to welfare. The path from the bankruptcy courts to the welfare rolls is one that needs to be established by sociological research that Jackson does not even conceive of in his book.¹¹⁰

Jackson does end by concluding that keeping the welfare rolls free of deadbeats is not "the" explanation after all. But his refutation of his own straw-man argument is rather perplexing:

If the reason for making bankruptcy's discharge nonwaivable is to lighten the burden on the public fisc by reducing reliance on safety-net programs, there are alternative means to achieve this goal that would restrict individual autonomy less than the existing discharge rules do. If discharge law were concerned only with furthering this narrow goal, it could simply allow the debtor, after bankruptcy, to shield from garnishment a sum equal to the average weekly value of the safety-net benefits he would otherwise be entitled to. [p. 232]

Note the weird logical steps Jackson makes in this quotation: (a) There is a single "reason" fueling the law that needs to be decoded. (b) This reason is the maximization of personal autonomy, a principle on which, as Jackson states elsewhere, "much of American society in general[] is structured."¹¹¹ (c) It is a property of law's "reason" that it has been identified only when one can think of no alternative system that would "restrict individual autonomy less." (d) The debtor's autonomy¹¹² is maximized when the creditors are not allowed to garnish an amount of money set by some safety-net criterion. This would be accomplished by denying an able-bodied debtor welfare, so that the debtor would have to get a job. The debtor gets to keep just enough wages to equal his welfare entitlement. The rest of the wages goes to the creditors. Thus, since Jackson has thought of a less restrictive alternative for keeping the welfare rolls clear, he supposes that he has

110. If *any* kind of relation exists between bankruptcy discharge and welfare, it cannot be that able-bodied workers will collect welfare. Rather, it must be that the *dependents* of workers are abandoned and thrown into public welfare programs. Even so, major work must be done to show a relationship between declining wages and disintegrating families. Tossing off a few paragraphs alleging even this relationship (which Jackson does not do) would still be irresponsible scholarship, although it would be a clear advance over what Jackson suggests.

Judge Prudence Abram has recently suggested to me another kind of connection. She believes that a number of people who lose their jobs use their credit cards to get by until they can find a new job. If they cannot find one, bankruptcy ensues. If Judge Abram is right, then bankruptcy may be a kind of welfare system for the middle class and not a means of keeping the welfare rolls clear.

111. Jackson, *supra* note 50, at 1404.

112. Whether it is the debtor whose autonomy is enhanced is not exactly clear from the above passage.

defeated any causal relationship between bankruptcy discharges and welfare.¹¹³

Not many of these steps are comprehensible. Note in particular that Jackson assumes that coercing a person to substitute work for leisure will necessarily "maximize" autonomy, a rather startling conclusion.¹¹⁴ As usual, these assumptions are left totally undescribed and unjustified in the book.¹¹⁵

113. The Federal Consumer Credit Protection Act, 15 U.S.C. § 1673 (1982), already guarantees a person 75% of his wages, regardless of need. Therefore, his "least restrictive alternative" for keeping the welfare roles clear could be a much worse deal for a lot of debtors than the deal they get now under the FCCPA.

114. Jackson's assertion that the debtor's autonomy is enhanced if he is forced to go out and work when he would rather goof off simply fuels my suspicion that the word "autonomy" is infinitely corrupt and malleable. Jackson's logic of "autonomy" goes like this: (a) autonomy is desirable; (b) it is desirable to force a deadbeat to do some work; (c) this program of coercion therefore enhances the deadbeat's autonomy. This sounds like totalitarian double-speak to me!

Putting welfare bums to work is not the only Tory note that Jackson sounds. One of my favorites: "It should not defy anticipation, for example, that the student radical of twenty may become a business leader — or a born-again Christian — by forty." P. 234.

115. Do I have any better suggestions about the meaning of bankruptcy discharges? I think so. An investigation of history suggests some rationalities that are far removed from self-pater-nalism fueled by fear and pessimism. The historical record suggests that we divide bankruptcy discharges into two types: (a) the version in which creditors have a power to deny the debtor a discharge, and (b) the version in which qualifying debtors obtain a discharge even if all the creditors dissent.

Initially, there were no bankruptcy discharges. According to some historians, this state of affairs (lasting up to the eighteenth century) was consistent with a deep suspicion of credit and a thorough opprobrium against persons who fell into debt. Ayer, *How to Think About Bankruptcy Ethics*, 60 AM. BANKR. L.J. 355, 367 & n.39 (1986); Duffy, *English Bankrupts 1511-1861*, 24 AM. J. LEGAL HIST. 283 (1980); Weisberg, *supra* note 43. But even in those days, profit-maximizing creditors might (and did) offer discharges anyway through creditors' compositions. Although we are accustomed to thinking of (rich) creditors as powerful and (poor) debtors as weak, anyone who has been a creditor knows different. The debtor has an enormous positional advantage over his creditors. See Carlson, *Is Fraudulent Conveyance Law Efficient?*, 9 CARDOZO L. REV. (forthcoming) (finding positional advantage of debtors the major target of fraudulent conveyance law). He can hide assets, make fraudulent conveyances, prefer other creditors, or "flee to continental towns, such as Boulogne, where there were sizable colonies of Englishmen waiting for . . . favourable compositions." Duffy, *supra*, at 291. Such possibilities gave debtors real leverage over creditors to trade compositions for production of assets. See Cohen, *The History of Imprisonment for Debt and Its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153, 154, 158-59 (1983) (reporting on creditor compositions in English history).

Historians claim that by the time the earliest discharge law was introduced, the prevailing attitude toward credit had changed. Traders who took honest risks and lost were no longer hated and feared. The social utility of risk-taking came to be recognized. Weisberg, *supra* note 43, at 29-34. This 1705 legislation allowed discharge of qualified debtors by class vote of creditors. See Duffy, *supra*, at 287-91; see also Ayers, *supra*, at 367 & nn.40-43 (describing class votes in early American legislation). Therefore, to some degree, the existence of consensual discharge legislation may be described as replicating bargains that a lot of debtors and creditors would make anyway, with the additional proviso that the minority of dissenting creditors would not be permitted to block the benefits of a composition that most creditors preferred.

This version of the bankruptcy discharge seems fueled by the desire to induce the debtor to produce assets that otherwise could be hidden, when the creditors decided it was in their class interest. Here the motive of discharge law seems a combination of improving the collection procedure and encouraging the debtor to deal honestly and openly with his creditors. Cohen, *supra*, at 156-57. This element of exchange and incentive is not absent from discharge law today.

II. BANKRUPTCY AS NEUTRAL FORUM

In addition to contractarianism, Jackson has another major normative principle to push. According to Jackson, bankruptcy should always be neutral toward creditor rights in state law. Otherwise, "incentives" are created whereby firms that should not be in bankruptcy are pushed into it, and vice versa.¹¹⁶ Large portions of Jackson's book are dedicated to a relentless inquisition of bankruptcy rules, to see which are neutral and which are not.¹¹⁷

See 11 U.S.C. § 727(a) (1982 & Supp. III 1985) (only debtors who cooperate in producing assets are entitled to a discharge).

The second version of bankruptcy discharges fully emerged in the 1898 Act, which forced discharges against the will of the creditors. It was here that creditors were *forced* to surrender their private spite for defaulting debtors. "Mandatory" discharges obviously have no basis in freedom of contract. At this point, discharge law passed out of a democratic-utilitarian phase and into a new intuitionist-liberal phase. Instead of facilitating rational agreements (against hold-out creditors who threatened to defeat a composition), the mandatory legislation clearly indicates that the bargain ought to be made, regardless of creditor opposition. This change could be viewed as reflecting a growth in society's confidence about the strength of its foundations. The nature of this change was that, earlier in history, there was great hatred for those who did not keep their promises, but that later people felt less threatened by default and hence more willing to see it forgiven. In fact, society has an important interest in *forcing* the injured parties (*i.e.*, the creditors) to defer all questions of justice and punishment to the authorities, *see* Boshkoff, *supra* note 24, at 104, and to free up honest debtors who might make contributions to society if freed from debt. *Cf.* P. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA* 250 (1974) (debtor's prison harmed society by removing productive laborers from the work force).

I have called this phase the "intuitionist-liberal" phase. What I have in mind is that the philosophical justification for the discharge was to preserve individuals from permanent subjugation to their creditors. This was done by making the discharge nonwaivable by the debtor. Doctrines of unwaivability have an obvious built-in contradiction: individuals are prevented from exercising the choice that individualism seeks to protect, in order to preserve the illusion of individualism. The idea of an unwaivable right reflects the fact that the idea of individualism is inherently self-contradictory as an ethical theory. Therefore, bankruptcy discharge represents a failure of *pure* liberal theory (although undoubtedly a triumph of common sense). This is the meaning I would give to mandatory discharge law.

This account is not startling or original. It is a modest one, based on the orthodox historical view of bankruptcy discharges, with a light touch of critical theory thrown in. It relies in part on intuitionism — a declaration that competing values are in fact balanced and answers achieved, even if the balancing mechanism has not been and perhaps cannot be described. Such an explanation lacks the éclat of Jackson's discovery of a single "deep structure," but at least it avoids the controversial theories of personality upon which Jackson so heavily depends.

116. Pp. 21, 26, 33, 35, 57, 79, 83, 193. Ultimately, the idea of bankruptcy neutrality shares an important element with Jackson's efficiency-related contractarianism. In both ideas, Jackson aims for Paretian overtones, whereby bankruptcy is thought to harm no one and benefit at least one party. Thus, his contractarian model has people *consenting* to the rules, thereby proving that no one is harmed by whatever rule he is justifying. Similarly, in his bankruptcy optimum, he bids legislators to guarantee that no one is harmed by a bankruptcy rule. Jackson is not necessarily against the infliction of pain, however. He simply wants to be sure that pain is inflicted by a nonbankruptcy rule. P. 25. Such a Paretian bankruptcy concept depends heavily, of course, on Jackson's dream-world assumption that all creditors are equal under state law, so that in bankruptcy all creditors gain and no one loses. I criticize this argument in the text at notes 25-32 *supra*.

117. Jackson obtained the idea of bankruptcy neutrality from *Butner v. United States*, 440 U.S. 48 (1979), which Jackson quotes as follows:

Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of

Although it hardly seems possible, the idea of bankruptcy neutrality is even less satisfactory than Jackson's contractarian claims. This section will sketch out some of the major failures in the bankruptcy neutrality idea.

A. *There Can Be No Such Thing as Neutrality Between State Law and Bankruptcy*

In order for a totally neutral environment to exist whereby creditors can choose between bankruptcy and nonbankruptcy liquidation systems, the following formula must hold for each and every creditor:

$$\frac{C_s}{E_s} = \frac{C_b}{E_b}$$

where C_s is the creditor's expected return under state (or nonbankruptcy) liquidation systems, C_b is the creditor's expected return from a

property interests by both state and federal courts within a State serves to . . . discourage forum shopping . . .

P. 22 (quoting *Butner*, 440 U.S. at 56).

Since Jackson pins so much of his book on this dictum from the Supreme Court, it is amusing to consider the facts of the *Butner* case. Ironically, one would be hard pressed to find *any* bankruptcy case as non-neutral as *Butner*, in spite of the above-quoted slogan about forum shopping.

In *Butner*, the issue was whether accumulated rents from land belonged to the secured parties or to the bankruptcy trustee. Under North Carolina law, mortgagees have to dispossess the debtor before they are entitled to mortgage payments. The mortgagees (including the petitioner, *Butner*) had in fact obtained a receiver from the bankruptcy court. This receiver collected rents for all the mortgagees. All sides agreed that this receiver was authorized to collect rents on behalf of the mortgagee. See *Golden Enters. v. United States*, 566 F.2d 1207, 1210 (4th Cir. 1977) ("Of course, there had been a receiver until the adjudication in bankruptcy and he had applied the rents collected, *inter alia*, to the payment of interest and principal on the mortgages."); see also 566 F.2d at 1212 (Bryan, J., dissenting) ("The next day the order was entered naming Simon Joseph Golden as agent 'to collect rents and to apply the proceeds'. . . to the '5. Interest and principal on secondary mortgages' which, of course, included appellee *Butner's* mortgage.").

When the debtor's proceeding was converted to a liquidation, this receiver was displaced by the bankruptcy trustee, who terminated *Butner's* right to the rents. The reason *Butner* lost the rents is that he made no separate request to the bankruptcy courts for the rents after his receiver was displaced, even though he had obviously made this request before the receiver was displaced. See 566 F.2d at 1211 (Bryan, J., dissenting) ("Despite the recital of other reasons, the majority decision actually turns on the single axis: that appellee, the second mortgagee, failed to renew 'during bankruptcy' a request made during the arrangement phase for a sequestration of rents for his benefit.") (emphasis in original).

If there had been no conversion of the action to a bankruptcy liquidation, obviously *Butner* had qualified to receive rents. Yet it was the failure to follow a rule of *bankruptcy* procedure that did *Butner* in. See 566 F.2d at 1210 ("the record reflects no formal action on the part of *Butner* to proceed with foreclosure in compliance with Bankruptcy Rule 701").

All this went over the head of the Supreme Court, which affirmed the non-neutral result reached by the lower courts. The Supreme Court was very concerned to terminate a split among the circuits about whether any request for sequestration of rents was required at all. Some circuits held that the request must be made when state law required it. Other courts waived the requirement on the ground that it was a needless formality. In fact, since *Butner* had made the request required by state law (but had not followed a rule of bankruptcy procedure), there was no need to resolve the split among the circuits. In the end, the result in the case violated the very principles of bankruptcy neutrality that Jackson holds so dear. See p. 21 (dismissing the facts of *Butner* as "unimportant").

bankruptcy proceeding, while E_s and E_b are the value of the entire estate in a state-law proceeding and in a bankruptcy-law proceeding. If (and only if) the above formula is true for each and every creditor, then (and only then) will creditors choose between state law and bankruptcy law based solely on the efficiency of the competing collection systems. If even one creditor faces a priority regime when $C_s E_b \neq C_b E_s$, then the entire legal regime is not neutral.

Where bankruptcy treats general creditors as equal, while state law permits creditors to be paid or to obtain judicial liens, the above formula never holds. The implication of this observation is that bankruptcy equality (the essence of bankruptcy, says Jackson) is itself non-neutral in relation to state law. Therefore, the suggestion that bankruptcy should have no substantive content is inherently impossible.

This one observation alone destroys huge portions of Jackson's book. And yet even if it were possible to assert that the above ratios could be equal (where state law allows unequal payment and bankruptcy insists on equal payment), there are many more objections to Jackson's thesis, each of which is fatal in its own right.

B. *Debtor-Creditor Federalism As a Value More Important Than Efficiency*

The above section assumes that Jackson uses bankruptcy neutrality to achieve efficiency. There is much in Jackson's book to support this interpretation, but, from time to time, Jackson also indicates that bankruptcy neutrality is not merely instrumentally useful in pursuing efficiency. Nonbankruptcy law may well be inefficient or even unfair, but Jackson still thinks that bankruptcy must never erode any state-law entitlements. Indeed, efficiency and bankruptcy neutrality are contradictory principles.¹¹⁸

Jackson even discusses an attractive candidate for an efficient, non-neutral bankruptcy rule which must not be instituted: Involuntary creditors could be promoted over voluntary secured creditors, who could respond by raising interest rates to the debtor, thereby forcing the debtor to internalize costs. Internalized costs would by themselves reduce the number of bankruptcies in the long run. Jackson opposes this rule because it is not neutral between conflicting state-law entitle-

118. One quite excellent article that spells this out is Bulow & Shoven, *The Bankruptcy Decision*, 9 BELL J. ECON. 437 (1978). In this article, the authors give examples of (a) a firm with going-concern value being liquidated in order to profit well-mobilized creditors, and (b) a firm without going-concern value being preserved in order to profit well-mobilized creditors. In each case, the bankruptcy norm of creditor equality produces contrary incentives because the well-mobilized creditors can choose state law or bankruptcy law to produce self-serving nonefficient results. The implication of this article is that bankruptcy cannot be neutral and efficient at the same time.

Although this article is quite imaginative, the authors leave out the possibility of a Chapter 11 reorganization, which would change several of their examples, although not their basic point about the inconsistency of bankruptcy neutrality and efficiency.

ments (pp. 31-32, 156). Under state law, secured creditors almost always take priority over unsecured tort creditors.¹¹⁹

Jackson, then, privileges a vague sort of debtor-creditor federalism over efficiency. If this debtor-creditor federalism is more important than efficient law, then Jackson really ought to have explained what values debtor-creditor federalism serves. Advocates of states' rights usually assert that state sovereignty allows for greater citizen participation and experimentation in governmental affairs than is possible in a national government,¹²⁰ but Jackson cannot assert these goals for his neutrality principle. Jackson concedes that federal law might contribute to nonbankruptcy law, as well as law produced by local governments. Therefore, bankruptcy neutrality cannot be justified by ordinary federalism principles.

If I had to guess why Jackson asserts such a mysterious principle, I would say that Jackson views it as equally easy to legislate globally as to legislate a bankruptcy rule. There being no difference in effort, Jackson wishes to steer legislators toward the global solution.¹²¹ If there is to be efficiency, let it be both in and out of bankruptcy! The assumption that global legislation is so easy (if indeed Jackson is guilty of it) ignores at least three important practicalities. First and foremost, certain reforms can *only* be done in collective proceedings.¹²² This is so with regard to the very same non-neutral bankruptcy rule that Jackson proclaims efficient but solemnly opposes. As stated above, Jackson thinks that giving tort creditors priority over commercial lenders in state law might be efficient and endorses a nonbankruptcy rule to this effect. But how would a "first in time" state-law system achieve this? In a system in which all security interests and judicial liens obtained by commercial lenders are susceptible to subordination to any and all tort creditors, huge "marshaling of assets" problems arise.¹²³ Unless bankruptcy (or a state-law collective sys-

119. *E.g.*, U.C.C. § 9-301(1)(b) (1978).

120. *E.g.*, Rudenstine, *Judicially Ordered Social Reform: Neofederalism and Neonationalism and the Debate Over Political Structure*, 59 S. CAL. L. REV. 449, 465-68 (1986).

121. I have deduced this premise from passages such as this one:

Even though a nonbankruptcy rule may suffer from infirmities such as unfairness or inefficiency, if the nonbankruptcy rule does not undermine the advantages of a collective proceeding . . . imposing a different bankruptcy rule is a second-best and perhaps a counterproductive solution . . . [T]he proper approach for Congress would be to face that issue squarely and to overturn the rule in general, not just to undermine or reverse it in bankruptcy.

Pp. 26-27.

122. Jackson actually sees this with regard to bankruptcy discharges. Pp. 226-27. Because discharge concerns only debtors who are human beings, Jackson has declared bankruptcy discharges as "out of bounds" for the bankruptcy neutrality principle. This he must do if he is to stay true to the task of justifying the status quo.

123. For example, suppose *D* commits a tort against *V*, so that *V* has a claim for \$10,000. Meanwhile, *D* has pledged his only three assets (each worth \$8,000) to three banks, *A*, *B*, and *C* respectively. Each bank has a secured claim of \$6,000 against *D*. If *V* is senior to the liens of *A*, *B*, and *C*, how can the banks ever foreclose on their mortgages? In a collective proceeding, this

tem) intervenes with a rule, it is hard to imagine how state law can even solve the problem of allocating bank collateral equally among tort creditors. Yet unless this allocation is made, creditors may overestimate the risk that tort creditors really pose. Therefore, prohibiting a bankruptcy rule about tort creditors is tantamount to ruling out the chance of efficient reform forever.

A second practical objection to bankruptcy neutrality is that the legislator or judge in question may have jurisdiction over bankruptcy but not over anything else. In particular, a bankruptcy judge has the chance to overrule state law's bad influence by molding a federal rule in a bankruptcy proceeding. A bankruptcy judge who adopts Jackson's neutrality principle thereby freezes herself into inaction when she thinks action is called for.

Finally, state legislators have limited impact in making reforms, partly because choice-of-law problems limit the impact of any state's law and partly because commercial legislation is heavily lobbied by special interest groups. Therefore, bankruptcy judges are being asked to do nothing in the hopes that palpably disempowered state legislators will make the desired debtor-creditor reforms.

One last observation. The history of debtor-creditor law is filled with examples in which state law changed in order to conform with bankruptcy rules.¹²⁴ That is, not only is bankruptcy neutrality a bad strategy for reform, but the evidence shows that state courts and legislatures are capable of responding to the stimulus of a bankruptcy rule. Why does it follow that bankruptcy courts must be neutral, when state courts and state legislatures have the power to neutralize a bankruptcy rule by conforming state law to it? In short, bankruptcy neutrality seems anti-reform, anti-efficiency, anti-fairness.¹²⁵ All this without

problem is easily solved, because all the parties will be part of the proceeding. Marshaling of assets would then easily give *V* her priority without visiting a disproportionate loss on either *A*, *B*, or *C*. Therefore, either bankruptcy must have a priority rule, or the state-law system of "first in time" must be changed into a collective proceeding.

124. A few quick examples: (a) After *Moore v. Bay*, 284 U.S. 4 (1931), the drafters of the U.C.C. eliminated the rights of unsecured creditors against unperfected security interests. See U.C.C. § 9-301 (1978); Carlson & Shupack, *Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code, Part I*, 5 CARDOZO L. REV. 287, 319 (1984). (b) The Uniform Fraudulent Conveyance Act has recently been rewritten to conform to changes made in the Bankruptcy Code. See Kennedy, *The Uniform Fraudulent Transfer Act*, 18 U.C.C. L.J. 195, 198-99 (1986). (c) "Under the dominant rule of nineteenth century common law, partnership creditors enjoyed a priority in the distribution of partnership assets. . . . This rule has come to be known as the 'jingle rule.' The jingle rule was included in the Bankruptcy Act of 1898 When the Uniform Partnership Act was promulgated in 1914, the jingle rule was codified in it, in part so that partnership law would correspond to section 5(g) of the Bankruptcy Act." *In re Safren*, 65 Bankr. 566 (Bankr. C.D. Cal. 1986). Congress has reversed field again and has now repealed the jingle rule. 65 Bankr. at 566.

125. "Even though a bankruptcy rule may suffer from infirmities such as unfairness or inefficiency, if the nonbankruptcy rule does not undermine the advantages of a collective proceeding . . . imposing a different bankruptcy rule is a second-best and perhaps counterproductive solution." P. 26.

anything resembling a convincing rationale!

C. *The Ad Hoc Nature of Debtor-Creditor Federalism*

Jackson spends a lot of pages asserting his mysterious federalism values over efficiency. But he also spends almost as many pages developing a whole series of efficient, non-neutral bankruptcy rules to which federalism is subordinated. That is, sometimes federalism is asserted over efficiency, and sometimes efficiency is asserted over federalism. This leaves Jackson's book deeply contradictory on whether bankruptcy should be neutral or whether bankruptcy should be efficient.

The efficient non-neutral bankruptcy rules Jackson favors include rules under which creditors forfeit their preferences and their positional advantages provided by state law.¹²⁶ This is done, apparently, in the name of efficiency. Thus, after learning that state-law entitlements should be honored above all things in bankruptcy, we now learn that state-law entitlements should be struck down when they are voidable preferences or when they fall to the trustee's status as hypothetical lien creditor.

Jackson does attempt a calculus to tell us when efficiency should or should not be asserted as the most important value. According to Jackson, bankruptcy should be non-neutral whenever such interference furthers the "goal" of bankruptcy. The "goal" of bankruptcy is the efficient maximization of value in the debtor's estate (pp. 14-16). In particular, Jackson imagines that bankruptcy equality among unsecured creditors is necessary to justify the maximization of the estate that bankruptcy supposedly achieves. Voidable preference law is therefore justified because it prevents creditors from opting out of this "bargain."¹²⁷

126. For example, suppose a creditor gets a lien under state law. This lien is a voidable preference if the debtor files for bankruptcy within 90 days. Bankruptcy therefore destroys nonbankruptcy entitlements in the name of efficiency. Pp. 125-26.

127. Jackson does not have a well-developed argument in favor of the efficiency of voidable preference law. He has two claims. First, voidable preference law is necessary to prevent dismantling the bankrupt estate. Pp. 125-26. Second, voidable preferences prevent wasteful costs of creditors in racing to get preferences. P. 128.

The first point seems flat wrong. Recall that the production of value enhancement in bankruptcy and entitlements to the gain are logically unrelated. If bankruptcy is designed to preserve going-concern value that (allegedly) cannot be achieved in state law, this could be preserved even if creditors who have established liens on property are given 100% of the value of liens. Creditors could be forced to return the property per se, so that the estate could be maximized, but the preferred creditor could then be given a priority to the bankruptcy gain that is created thereafter. After all, Jackson favors giving secured creditors their collateral. The effect of security interests on the bankruptcy gain seems identical to the effect a preferential judicial lien would have.

The second claim — legalizing preferences would encourage costs — also seems highly problematic. First, Jackson assumes that voidable preference law actually succeeds in discouraging creditors from attempting to get preferences. Such a claim is by no means self-evident, as Jackson himself commendably recognizes. Pp. 137-38. Also, Jackson does not mention the counter-costs voidable preference law might cause. In particular, voidable preference law causes the trustee and other creditors to spend money to find the preferences and, in some cases, might

It can be seen that, even though Jackson opposes efficiency when it contradicts bankruptcy neutrality, efficiency is nevertheless at the heart of bankruptcy neutrality after all. Therefore, Jackson favors some non-neutral bankruptcy rules because they are efficient. He opposes other non-neutral rules even though the rules are efficient. Sometimes efficiency is good and sometimes it is bad. So-called "bankruptcy" efficiencies may be pursued, but other types of efficiency may not be pursued.

If efficiency is what Jackson is after, and if it is unambiguously achievable, why not use non-neutral bankruptcy rules to pursue it? For that matter, why not create all sorts of non-neutral incentives to encourage someone to file a bankruptcy petition, in order to make sure that society enjoys the efficiencies to be found there?¹²⁸

There is a second way in which Jackson's modulation between efficiency and neutrality is ad hoc. He assures us that sometimes it is "too expensive" to be neutral. For instance, Jackson is troubled by the fact that unperfected security interests are void in bankruptcy, rendering the unperfected, secured creditor equal to the general creditor. Although Jackson concedes that unperfected, secured parties might have a big head start in a state "first in time" collection system, Jackson nevertheless favors (non-neutral) equal priority because non-neutrality is "preferable to a more costly case-by-case standard."¹²⁹ This deduction of prohibitive cost from the existence of a non-neutral bankruptcy rule may be (to be polite) mediocre sociology,¹³⁰ but it is an eloquent admission of the proposition that efficiency and neutrality are completely incompatible and contradictory ideas.

Having admitted that bankruptcy law cannot always be neutral (because sometimes neutrality is too expensive), it is incumbent upon Jackson to explain how much neutrality is worth (assuming for the sake of argument that it is worth anything at all). The observation that "sometimes bankruptcy neutrality is too expensive and sometimes it's not" does not exactly enlighten us on how to tell the difference.

justify creating a bankruptcy proceeding when, otherwise, none would occur. That voidable preference law is efficient is a great leap of faith by Jackson.

128. For a typical non-neutral rule that indulges in this suggestion, see 11 U.S.C. § 503(b)(3)(A) (1982) (giving creditors who file involuntary petitions reimbursement for having done so).

Jackson's view is that, often, general creditors have no incentive to force a bankruptcy, even when bankruptcy has succeeded in maximizing the debtor's estate over state-law procedures. P. 205. He even suggests that a (non-neutral) reward be given to *shareholders* if they agree to the filing for bankruptcy. If this is so, it seems silly to wring hands over "bad" incentives that encourage *creditors* to seek earlier bankruptcies.

129. P. 74; *see also* pp. 15 n.18, 129.

130. It's a tactic that Jackson uses repeatedly! *See* pp. 72-74 (it's too expensive to look into whether unperfected, secured parties are really better off than general creditors under state law); pp. 130-31 (preference statute is so rigid because cost of a more exact standard is too high); pp. 199-200 (although cash-flow tests do not perfectly determine debtor insolvency, increased accuracy of alternative tests "may not be worth its costs").

Jackson does not even see that he needs to tell us this. He limits his task to praising the Bankruptcy Code when it appears to be neutral and apologizing for it when it is non-neutral on the grounds that deduced "costs" prevent neutrality.

D. *An Inconsistent View of the Efficiency of Bankruptcy*

Although Jackson sometimes claims that bankruptcy neutrality is different from and privileged over wealth maximization, Jackson asserts (inconsistently) that the purpose of bankruptcy is wealth maximization (pp. 12-14). But if bankruptcy were always efficient in comparison to the nonbankruptcy liquidation procedure, wouldn't incentives leading creditors toward bankruptcy be a good thing?

Jackson repeats again and again that he hates such incentives, however. His stated reason: even though bankruptcy exists because it is more efficient than nonbankruptcy liquidation alternatives, nevertheless there are *inefficient* bankruptcies that could occur if creditors have non-neutral bankruptcy rights. Jackson writes: "The concern [with non-neutral bankruptcy rules] . . . is not simply distributional — that some creditors would win and some would lose — but that the creditors as a group would suffer a net loss because the incentives for strategic use of bankruptcy by individual creditors would increase" (p. 79).

In this passage, Jackson asserts that there is such a thing as inefficient bankruptcy. Jackson never describes what he means by inefficient bankruptcies. He *does* state that bankruptcy is efficient because (1) the creditors supposedly bear fewer aggregate enforcement costs in bankruptcies (compared with the state-law alternatives), and (2) bankruptcies can capture going-concern value from creditors who would like to liquidate (whereas state-law systems supposedly cannot) (p. 14). Not all bankruptcies involve going-concern value. Chapter 7 liquidations can occur with or without it. It therefore follows, by process of elimination, that Jackson must think that in some bankruptcies aggregate creditor enforcement costs would be lower if the firm were liquidated under nonbankruptcy law. If I have successfully guessed the nature of an inefficient bankruptcy, then obviously whether bankruptcy or state-law procedures are wealth-maximizing must be decided on a case-by-case basis. Bankruptcy neutrality therefore seems aimed at guaranteeing that the choice made by creditors (bankruptcy or no bankruptcy) will be efficient.

If this is what Jackson means when he denounces disincentives, I find several things wrong with the account. First, if bankruptcy is efficient *most* of the time, then aren't non-neutral incentives good *most* of the time as well? Under the standard precepts of rule utilitarianism, bankruptcy neutrality is a bad idea, unless bankruptcy is inefficient precisely as often as it is efficient, in which case one may wonder (from

a utilitarian point of view) whether there should be a Bankruptcy Code at all.

Second, Jackson assumes that every non-neutral law produces a *result* in society. It could be, however, that the cost to the creditor of precipitating an involuntary (inefficient) bankruptcy far outweighs the benefit received from the non-neutral bankruptcy rule. As evidence of the fact that bankruptcy law might be irrelevant to the conduct of creditors much of the time, I can cite the fact that a vast majority of bankruptcy petitions are voluntary petitions filed by debtors, not creditors. With plenty of incentives for unpaid creditors to prefer bankruptcy — voidable preference law, priorities, and the like — creditors do not seem to be reacting in the way Jackson predicts. It seems that *debtors* are practically the only people deciding whether bankruptcy is a good thing.

Third, the choice between bankruptcy or state-law alternatives seems like a false dichotomy. In fact, creditors face at least seven choices: (a) privately negotiated loan workouts, (b) privately negotiated liquidations, refinancings, payments, and the like, (c) bankruptcy liquidation, (d) bankruptcy reorganization, (e) nonbankruptcy liquidation pursuant to legal process, (f) state-law receiverships designed to preserve going-concern value, and (g) doing nothing to enforce the debt at all. Even within these categories, there are numerous subdivisions that are possible, such as contesting a Chapter 11 plan, voting against the plan, voting for the plan, obtaining a Chapter 11 trustee, and so forth. Jackson's limited notion that non-neutral bankruptcy rules skew the choice between bankruptcy *vel non* radically underdescribes the choices that real creditors face.

E. *The Theory of the Second Best*

Jackson's neutrality position has a further problem which he does not acknowledge — the problem of the "second best." The second-best problem arises whenever there is more than one evil tendency in the world. In equilibrium theories, two wrongs most definitely constitute a right! Thus, a disincentive that moves people away from the optimum¹³¹ in the abstract may actually be helpful, because it counters the bad effect of another bad incentive. The theory of the second best, then, tells us that it is never enough to proclaim a tendency nonoptimal. The analyst must also demonstrate that the tendency is not needed to counteract some other, more serious counter-tendency.¹³²

131. Of course, Jackson's optimum is $C_s E_s = C_b E_s$, which is inherently impossible if general creditors are treated as equals. See Part II.A *supra*. The critique in the text presupposes, for the sake of argument, the coherency of Jackson's optimization claims.

132. Arthur Leff has written a trenchant description of the second-best problem: "If a state of affairs is the product of n variables, and you have knowledge of or control over less than n variables, if you think you know what's going to happen when you vary "your" variables, you're

The implication of the theory of the second best for Jackson's book is that Jackson cannot pick out disincentives and urge their repeal in the abstract. To do so could produce just the opposite effect from what Jackson intends. Therefore, taking a position against any given incentive without also taking a generic position on the balance and counter-balance of all incentives can never be justified by the nature of true neutrality. Neutrality can only serve as a convincing slogan in a "vacuum of fact."¹³³

Before bankruptcy neutrality can even begin to make sense, Jackson has to assure us that he has succeeded in removing *every* non-neutral bankruptcy rule. If he allows even one non-neutral rule to survive, removing any countervailing incentive is inefficient. Yet Jackson explicitly endorses lots of non-neutral rules (such as avoiding preferences). Because Jackson is *not serious* about eliminating all disincentives for and against bankruptcy, it is worse than useless for him to assert bankruptcy neutrality on an ad hoc basis.

F. *The Indeterminacy of State Law and the Impossibility of Neutrality*

According to Jackson, bankruptcy courts should find out precisely what rights creditors have at state law and then guarantee them at least that much in bankruptcy. This view presupposes that state law is determinate and yields an answer. In making this assertion, Jackson ignores almost eighty years of legal realism and (more recently) critical legal theory.

Most modern philosophers of law would tend to agree that [i]t will always be possible to find, retrospectively, more or less convincing ways to make a set of distinctions, or failures to distinguish, look credible. A common experience testifies to this possibility; every thoughtful law student or lawyer has had the disquieting sense of being able to argue too well or too easily for too many conflicting notions.¹³⁴ This is no less true with regard to debtor-creditor law. Equity courts in particular have always been heavily involved in debt collection. Equity jurisprudence is full of slogans, such as "equity abhors a forfeiture" or "clean hands," which justify reversing a result that someone

a booby." Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451, 476 (1974).

Second-best problems are everywhere. The law-and-economics movement almost always ignores these problems, negating any claims to utilitarian truth that such scholarship might make. For two excellent (if difficult) essays on second-best problems lurking in microeconomic analysis, see Markovits, *A Basic Structure for Microeconomic Policy Analysis in our Worse-than-Second-Best World: A Proposal and Related Critique of the Chicago Approach to the Study of Law and Economics*, 1975 WIS. L. REV. 950; Markovits, *supra* note 94.

133. See Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929 (1985) (exploring second-best factors that militate in favor of allowing creditors to take security).

134. Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 570 (1983).

claims under state law. Indeed, it is safe to say that the whole purpose of equity is to render the law indeterminate.

If it is true that the law is indeterminate, not just some of the time, but all of the time, then Jackson's neutrality principle is useless.¹³⁵ Inevitably, the bankruptcy judge must mediate between conflicting state-law norms. This mediation can be accomplished only through the use of some theory or intuition that is not part of the neutrality principle.¹³⁶

In short, Jackson's neutrality principle reduces to atavistic formalism — the idea that neutral judges can simply consult the law and find the answer, without ever having to exercise judgment. Formalist legal theory has not been respectable since Roscoe Pound demolished it way back in the Roosevelt administration.¹³⁷ Yet if there is any difference between Jackson's bankruptcy neutrality theory and the "mechanical jurisprudence" Pound denounced, it is not a difference that I can

135. "The economist will ask the lawyer 'what the law is' with respect to a particular externality. If the lawyer says, 'this is a case of first impression,' or 'there is no law,' the economist cannot proceed." Kennedy, *supra* note 29, at 430 n.103.

136. To put the indeterminacy of state law to the test, let me take as a challenge Jackson's assertion that state law guarantees secured creditors their opportunity cost. The implication of this view is that, under principles of bankruptcy neutrality, undersecured creditors should get paid postbankruptcy interest so long as the trustee retains the collateral or proceeds of the collateral. Pp. 184-85; Jackson, *supra* note 17, at 876. Presumably this view is based on the right of the secured party to repossess and sell. See U.C.C. §§ 9-501, 9-504 (1978). The secured party then presumably invests the proceeds in his most profitable opportunity.

It is possible to argue that opportunity cost depends upon how quickly the undersecured party really could get her hands on the proceeds. Until then, the undersecured party has no opportunity cost. The debtor, however, does not have to hand over the collateral immediately. The debtor can threaten a breach of the peace, in which case the secured party must get replevin. See U.C.C. § 9-505 (1978). If the debtor takes every appeal and finds every way to delay, the time after which the secured party obtains an opportunity cost is delayed. Even if *eventually* the secured party must get her hands on the proceeds from the collateral, the debtor, consistent with state law creatively used, is entitled to impose all sorts of defense costs against the secured party, which should properly be offset against the opportunity cost. See D'Amato, *Legal Uncertainty*, 71 CALIF. L. REV. 1, 33-34 (1983) (defendants have systematic advantage in imposing litigation costs on plaintiffs). Cf. p. 72 (Jackson uses this argument to show that unperfected, secured parties are no better situated than unsecured creditors, so that the trustee's power to destroy the unperfected interest is justified).

We can go further. If the debtor possesses the collateral, the debtor can deny the creditor her opportunity to sell the collateral and reinvest by blowing up the collateral with dynamite. Granted, such behavior by the debtor is not lawful, but why should counterfactual prediction be bounded by the unrealistic assumption that debtors never break the law? Nothing in the rules of counterfactual historicism requires, or even recommends, such an assumption. Any policy maker trying to predict the future would be counted very foolish indeed if she always assumed that human agents act consistently with the dictates of the law.

Therefore, just because a secured party under state law theoretically gets to sell the collateral does not prove that state law (by itself) dictates or guarantees that the secured party always has the opportunity to do so. I maintain that this argument suffices to deny any undersecured party all or part of her opportunity costs (on the theory that state law dictates that she get it).

137. Theodore Roosevelt, that is! See Pound, *Mechanical Jurisprudence*, 8 COLUM. L. REV. 605 (1908). John Stick has written: "critical legal studies should be spending its time with traditional scholarship about politics, not about methodological issues. Mechanical jurisprudence has already been defeated." Stick, *supra* note 52, at 399-400. No falsier words have ever been published.

discern.¹³⁸

III. CONCLUSION

Thomas Jackson has written an unremittingly dreadful book. Let me quickly summarize the reasons why.

Jackson's project is to find the essences of bankruptcy law, prove that those essences are rational, usually by a contractarian claim, and use those essences to club to death the numerous exceptions he finds

138. An interesting rehabilitative strategy that is beyond the scope of this review (and not undertaken in Jackson's book) is that "state law" is not the hopelessly conflicting doctrines to be found in state statutes and judicial decisions. Rather, state law is a prediction of what state-law judges will do. Under this view, bankruptcy judges are required to guess, diversity-style, how human beings (state-law judges) would mediate between conflicting doctrines. Whereas doctrine is indeterminate, judicial behavior *can* become relatively predictable. See Yablon, *The Indeterminacy of the Law: Critical Legal Studies and the Problem of Legal Explanation*, 6 CARDOZO L. REV. 917 (1985) (arguing that the law is simultaneously indeterminate and potentially predictable).

I have three preliminary comments on such a strategy for rehabilitating the possibility (if not the point) of bankruptcy neutrality. (1) Substituting predictions of behavior for doctrine presupposes that the bankruptcy judge is not a state-law judge and may never contribute to the creation of state-law rules. This assumption is contrary to experience, since bankruptcy judges *do* have a great deal of influence over the commercial law applied by state courts. Accordingly, a bankruptcy judge may justifiably perceive that she is a state-law judge, in the sense of contributing influential interpretations of state commercial law. If the same bankruptcy judge also believes in bankruptcy neutrality, then she faces the dilemma of following the "law," which is a prediction of what she herself will do. To restate the dilemma, under the legal realist view of state law, is the law what the judge *does*, or is the law what others (not the judge) predict the judge will do? The first view suggests that state law is indeterminate, since the judge can do whatever she feels like. The second view (the "legal realist becomes judge" view) is equally indeterminate:

The *Realist* judge . . . must base her prediction on nothing but the proposition that she will interpret the law to be what she predicts her own interpretation will be; that is, that she will interpret the law to be what she will interpret it to be. And the incoherence in this theory of interpretation is not that she cannot get it right, but that she cannot get it wrong, because the only material on which the prediction may be based is the prediction itself.

Luban, *Fish v. Fish or, Some Realism About Idealism*, 7 CARDOZO L. REV. 693, 698 n.20 (1986) (emphasis in original).

(2) Whenever Bayesian policy scientists predict the future of human will, they usually account for uncertainty by discounting for the risk that the prediction might be wrong. For instance, a bankruptcy judge might be only 70% sure of what a state judge would do (or 70% sure of what she predicts she, as a state-law judge, will do). Accordingly, it follows that bankruptcy neutrality should award the winning party a 70% entitlement and the losing party a 30% entitlement. There is no reason to require an "all or nothing" element to the legal realist exercise. See Orloff & Stedinger, *A Framework for Evaluating the Preponderance-of-the-Evidence Standard*, 131 U. PA. L. REV. 1159, 1160 (1983) (analyzing this approach to liability).

(3) If a bankruptcy judge tries to figure out what judges will do (and not what doctrine says the judge should do), bankruptcy judges will have to account for the phenomenon that all commercial lawyers experience: state-law judges often make mistakes in applying doctrinal ideas (which they would not make if they had been sufficiently educated before *res judicata* set in). E.g., *In re Alberto*, 66 Bankr. 132 (Bankr. D.N.J. 1985) (Article 9 financing statement not good enough to beat trustee's hypothetical lien creditor power whenever the collateral falls under the Ship Mortgage Act of 1920, a palpably "wrong" statement of law). Therefore, in pursuit of replicating what state-law judges would do, should the bankruptcy judge anticipate the mistakes and deliberately award victory to the wrong side from time to time, or should the judge simply apply the doctrine in a scientific way, on the assumption that that is what *enlightened* state-law judges would do? The latter strategy simply reintroduces formalism, which is the very ghost we are trying to exorcise in this footnote. The former, however, is likely to infuriate the losing side.

that render bankruptcy law nonsystematic. But system alone, aside from its aesthetic appeal, is worthless. Jackson must explain to us the ethical norms that fuel these systems. Much of the time, Jackson does not bother to do so, leaving it to the reader to guess why his principles are indeed worth following. The principal norms seem to be sometimes utilitarianism, sometimes political science notions about federalism, and sometimes individualistic values separate from and hostile to utilitarianism. These norms will conflict frequently, but Jackson gives no justification for privileging one norm over another.

Meanwhile, contractarianism pervades Jackson's work and gives the appearance of a coherent deep structure, but it is a sham. Sometimes Jackson makes up contracts in pursuit of efficiency and sometimes he makes up contracts in pursuit of protecting the individual against the ruthless logic of contracts. Jackson is able to come up with contracts because he is willing to change the parameters of his ethical and psychological theories to get the result he wants.

The whole idea of finding a deep structure in a complicated, historical artifact such as the Bankruptcy Code was doomed from the start.¹³⁹ Considering the tens of thousands of congressmen, judges and lawyers who have contributed to the content of bankruptcy law, it would have been a miracle if all of them were driven by the same ethical impulse every time a legislative decision was made.¹⁴⁰ Legal texts are situated in history, and just as historical explanation is infinitely complex, so should we expect jurisprudential explanations to be infinitely complex, based on entropy, anomie, conflict, and confusion, as well as the dictates of logic and reason.

139. Some readers of this essay have complained that just because Jackson has failed to discover bankruptcy's deep structure does not prove it isn't there. Indeed, the assertion that there are no deep structures in law is itself a "deep structure" that disproves the very maxim asserted. Nevertheless, I wish to state my *faith* that no one will ever find the one and only principle that explains bankruptcy law, for roughly the same reasons that I don't think history is ever explicable by a single driving principle.

140. Here I paraphrase Unger, *supra* note 134, at 571. Nietzsche called Jackson's type of thinking Egyptianism — "the absence of historical sense, a hatred for the idea of development." F. NIETZSCHE, *TWILIGHT OF THE IDOLS* 1, quoted in M. FOUCAULT, *LANGUAGE, COUNTER-MEMORY, PRACTICE* 156 (1977).